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Ultra Vires Contracts of a Corporation

By Arthur Lawrence May

A corporation is an artificial being created by the State for the attainment of certain defined purposes, and vested with certain specific powers and others fairly and reasonably to be inferred or implied from the express powers and the object of the creation. Since a corporation is the mere creature of the legislature it has such powers only as are conferred upon it by its charter or articles of incorporation, and these powers may be conferred in any one of three ways: expressly, impliedly in one sense as being incidental to corporate existence or impliedly in still another sense as being necessary or proper in order to exercise the powers expressly conferred. In treating of the powers of a corporation Chancellor Kent, a long time ago, said that corporations have such powers as are specifically granted by the act of incorporation or as are necessary for the purpose of carrying into effect the powers expressly granted and does not have any others, and this is just as true today as it was in the yester-day of long ago. The charter of a corporation read in connection with the general laws applicable to it is the measure of its powers. Justice Gray of the United States Supreme Court in delivering an opinion in the leading case of the Central Transportation Company vs. the Pullman Palace Car Company, 11 S. C. R. 478, said, "The charter of a corporation read in the light of any general laws which are applicable is the measure of its powers, and the enumeration of those powers implies the exclusion of all others not fairly incidental." In fact, the articles of incorporation are the sole guide as to the authority possessed by the corporation for, as the Indiana Appellate Court in the case of the Seamless Pressed Steel and Manufacturing Company vs. Monroe 57 Ind. App. 136, said, a corporation has no greater authority or power than that granted by the sovereign power of the State.

An ultra vires contract is one not within the scope of the corporate authority under any circumstances, or in other words, an act of a corporation is properly said to be ultra vires when it is beyond the powers as conferred upon the
corporation. But in the language of the Iowa court in the case of the Marshalltown Stone Company vs. the Des Moines Brick Manufacturing Company, 126, N. W. 190, "Whatever may be fairly regarded as incidental to and consequential on those things which are authorized by the charter of a corporation will not be held ultra vires." Justice Gray, in the course of the same opinion, a portion of which we have previously quoted, said, "A contract of a corporation is ultra vires in the proper sense when such contract is outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature." The New York Court of Appeals, in the case of Bath Gaslight Company vs. Claffy 45 N.E. 390, laid down a rule for determining the ultra vires character of corporate contracts in the following language: "The validity of contracts of corporations is to be determined by comparing the contract made with the charter, and if on such comparison it appears that the contract was neither expressly authorized nor a necessary or reasonable incident to the exercise of the powers specifically granted, the contract is ultra vires." Justice Sheras of the Federal Supreme Court, in the case of the Jacksonville, Mayport and Pablo Railroad and Navigation Company vs. Hooper, 16 S.C.R., 379, sustained the above rule when he said, "The doctrine of ultra vires ought to be reasonably and not unreasonably understood and applied; and whatever may fairly be regarded as incidental to or consequential upon those things which the legislature has authorized ought not, unless expressly prohibited, to be held by judicial construction to be ultra vires."

It is a common error to confuse the terms, "illegality" and "ultra vires," which represent totally different and distinct ideas. A contract of a corporation may be both ultra vires and illegal, as for example a contract in unreasonable restraint of trade, though it by no means follows that because such a contract is ultra vires it is also illegal, since illegality is not necessarily characteristic of ultra vires contracts. When we say a corporate contract is ultra vires we mean that it is beyond the object of its creation as defined in the law of its organization, and therefore, beyond the powers conferred upon it by the legislature, but when we
say a corporate contract is illegal, we mean it is illegal on other grounds, in addition to being ultra vires; that is, unlawful in the sense in which a contract by an individual may be unlawful. Whether a contract is illegal or not is determined by its quality, and in this connection it matters little whether it be the contract of a corporation or of an individual; whether it be ultra vires or not is determined from a consideration of the powers expressly conferred upon the corporation by the instrument of its creation, together with those other powers implied in the purposes of its creation and in the powers expressly granted. Of course a contract by a corporation to do an immoral thing or for any immoral purpose, or against public policy, is void and gives no right of action. The New York Court of Appeals in the case of the Bath Gaslight Company vs. Claffy, 45 N.E. 390, in speaking of the illegal contracts of a corporation used the following language: "A contract by a corporation to do an immoral thing, or for any immoral purpose, or, to use a convenient expression, a contract malum in se is void and gives no right of action. The doctrine, however, is not peculiar to contracts of corporations. It has its root in the universal principle that persons shall not stipulate for iniquity."

When it is said that a corporation has such powers only as are expressly or impliedly conferred upon it by the legislature which created it, it is not meant that it is unable to do any act in excess of the powers conferred, but simply that it has no authority or right to do such an act. It can exceed its powers and when it does so rights and liabilities may arise out of such unauthorized or ultra vires acts. On the subject of the power and capacity of corporations to exceed their powers and do wrong, the Indiana court in the leading case of Wright vs. Hughes, 119 Ind. 324, said, "Corporations, like natural persons, have power and capacity to do wrong. They may in their contracts and dealings break over the restraints imposed upon them by their charter, and when they do so their exemption from liability cannot be claimed on the mere ground that they have no attributes or faculties which render it possible for them to act." The New York Court in the early case of Bissell vs. Michigan Southern and N. I. Railroad Company 22 N. Y.
said in this connection, "Like natural persons, they can overleap the legal and moral restraints imposed upon them; in other words, they are capable of doing wrong. To say that a corporation has no right to do unauthorized acts is only to put forth a very plain truism; but to say that such bodies have no power or capacity to err is to impute to them an excellence which does not belong to any created existence with which we are acquainted. The distinction between power and right is no more to be lost sight of in respect to artificial than in respect to natural persons, and the same court in a later case, Vaught vs. E. Building and Loan Association, 65 N.E. 496, in the course of an opinion on the subject said that "While corporations have no right to violate their charters, yet they have power to do so."

The modern and reasonable doctrine that contracts into which corporations may lawfully enter are such only as are expressly or impliedly authorized by their charters is nevertheless frequently disregarded in practice, and when this is done, and a corporation enters into a contract beyond its chartered powers the question arises, which has been the subject of debate and much contrariety of opinion, how shall such a contract be treated by the courts, and whether the contract can create any rights as between the parties which the courts will enforce. There are some propositions pertaining to the general subject which are beyond dispute. One is that a contract by a corporation to do an immoral thing, or for any immoral purpose, or, to use a convenient expression, a contract malum in se is void and gives no right of action. This doctrine, however, is not peculiar to contracts of corporations. It has its root, as was said in the New York case of the Bath Gaslight Company vs. Claffy, which we have previously cited, in the universal principle that persons shall not stipulate for iniquity. Another principle of general recognition is that a corporation cannot enter into or bind itself by a contract which is expressly prohibited by its charter or by statute, and in the application of this principle it is immaterial that the contract, except for the prohibition, would be lawful, for no one is permitted to justify an act which the legislature within its constitutional powers has deemed shall not be performed. But in not infrequent instances corporations enter into unauthor-
ized contracts which are neither mala in se nor mala pro-
hibits—that is, which are ultra vires merely, and not illegal —or where the only prohibition or restriction is implied from the grant of specified powers. It is this class of cases which open the field of controversy. Is such performed by one party but not performed by the other void as between them, to all intents and purposes, so that no recovery can be had under it against the party who has received the consideration for his promise or the benefit of the contract but neglects or refuses to perform it on his part, or is it so tainted with illegality that the courts must refuse to recognize it under any circumstances or enforce its obligation, whether as to past or future transactions? It is with this question we are to deal.

The reasons why a corporation should not be held liable upon a contract ultra vires, that is to say beyond the powers conferred upon it by the legislature, and varying from the objects of its creation as declared in the law of its organization, are clearly and concisely set out in the opinion rendered by Justice Gray of the United States Supreme Court in the case of the Pittsburgh, Cincinnati and St. Louis Railroad Company vs. the Keokuk and Hamilton Bridge Company, 9 S.C.R. 770, and are as follows:—"1. The interest of the public that the corporation shall not transcend the powers granted; 2. the interest of the stockholders that the capital shall not be subjected to the risk of enterprises not contemplated by the charter and, therefore, not authorized by the stockholders in subscribing for the stock; 3, the obligation of every one entering into a contract with a corporation to take notice of the legal limits of its powers." Although it seems perfectly clear from the foregoing reasons that a corporation should not, on sound legal principles, be held liable on their ultra vires contracts, there exists much diversity of opinion on the question, whether, and under what circumstances, an action will lie on an ultra vires contract. The conflict in the authorities on this interesting question and the confusion in the cases dealing with this subject are largely due to the fact that since the safety of men in their daily contracts requires that the doctrine of ultra vires shall be confined within narrow limits, the courts have sought to regulate and restrict the defense of ultra vires so as to
make it consistent with the obligations and demands of justice, and so by the majority of them the defense of ultra vires has come to be regarded as an ungracious and odious one. There have consequently sprung up two lines of decisions dealing with the corporations' liability on their ultra vires contracts. If the contract has been fully executed on both sides, or is executory on both sides, no difficulty arises, for it is true in practically all jurisdictions that courts will not interfere in the case of contracts executed as to both parties at the instance of either one of them towards what has been done, as was the sound opinion of the Alabama court in the case of Long vs. the Georgia Pacific Railroad Company, 9 So. 706, when it said, "When the contract is fully executed, where whatever was contracted to be done on either hand has been done, the law will not interfere, at the instance of either party, to undo what was originally ultra vires, and to the doing of which, so long as the contract to that end remained executory neither party could have coerced the other." Likewise when the contract is entirely executory neither party can maintain an action upon it. The almost universal rule as applied to executory contracts is that a corporation when sued thereon may set up as a complete defense to its liability that it had no power to enter into the contract—that the contract is, in the strict sense, ultra vires, and on this particular point the Indiana court in the oft-cited case of Wright vs. Hughes, 119 Ind. 324, said, "Where a corporation makes a contract that is in excess of its chartered powers it may well be that while the agreement remains wholly executory it cannot be enforced. So long as the contract is unexecuted it does not estop the corporation because the power of a corporation, like that of a person under a legal disability, cannot be enlarged by the mere form of contract which it had no capacity to make."

The difficulty arises when the ultra vires contract to make. The difficulty arises when the ultra vires contract has been fully performed by one of the parties but has not been performed by the other party, or, in other words, when the contract is fully executed on one side and entirely executory on the other, and it is in dealing with this class of ultra vires contracts that there is found such diversity of opinion
and direct conflict in the authorities which is shown by two lines of decisions above referred to and of which we shall now have more to say.

Some of the courts, notably the Federal and Illinois courts, hold that a contract by a corporation which is objectionable only because it is ultra vires or unauthorized is on that ground alone unlawful and void as being beyond the powers conferred upon it, and that, as a rule, no action can be maintained upon it. But where the contract has been executed on one side, and either party has received benefits under the contract in the form of money, property or services, an action, quasi ex contractu, or suit for an accounting, may be maintained to recover therefor. This is known as the strict or Federal rule. Most courts, notably New York and Indiana, hold that the contracts of a corporation which are objectionable only because they are ultra vires are not so far illegal that no action can be maintained upon them, and that the plea of ultra vires should not prevail, whether interposed for or against a corporation when it would be inequitable and unjust to allow it; thus where the party seeking to enforce the contract has performed it on his part the other party is prevented from setting up the defense of ultra vires and this is known as the prevailing rule. There is still another doctrine known as the Progressive Kansas doctrine that has recently sprung up, and that has been followed by just a very few courts, which holds that in case of executory contracts neither the corporation nor the person contracting with it can question the power of the corporation to enter into the contract, the situation being likened to the estoppel to deny corporate existence where one contracts with the other party as a corporation, and there is well-considered authority for this position. In *Harris vs. the Independence Gas Company*, 92 Pac. 1128, the leading case on this practically new doctrine the Kansas court expressed the following opinion: "It would seem reasonable that a system which attempts not only to protect a party to ultra vires contract from actual loss but where equity requires it to insure to him the fruits of his bargain ought, for the sake of completeness and symmetry, to enable him to insist upon the performance even of a purely executory contract. It certainly seems against conscience that
one who has entered into a contract with the expectation of deriving a profit from it may, upon discovering the probability of loss, repudiate it and escape responsibility by raising the question of want of corporate capacity. Parties to a contract who deal with each other upon the assumption that one of them is a corporation are ordinarily precluded from questioning the validity of its organization. The question of the character of business a corporation is authorized to engage in is ordinarily a matter between it and the State, not open to collateral inquiry; and one who has entered into a contract with a corporation which is otherwise unobjectionable cannot maintain an action for its cancellation upon the ground that it relates to a transaction foreign to any purpose mentioned in the company's charter. The doctrine that only the State can challenge the validity of acts done under color of a corporate charter, if accepted, must necessarily protect an executory contract from collateral attack equally with one that has been executed. The court is convinced of the soundness of the view that in the absence of special circumstances affecting the matter neither party to even an executory contract should be allowed to defeat its enforcement by the plea of ultra vires. The doctrine is logical in theory, simple in application and just in result." The basis of this doctrine is upon grounds of public policy, and not upon the ground of equitable estoppel upon which is based, as we shall presently see, the prevailing rule that where a contract is executed on one side and is still executory on the other but the party as to whom it is executory has accepted and made his own the benefits of the contract he has estopped himself from denying in the courts the invalidity of the instrument by which those benefits came to him. The logic used by the Kansas court in rendering this decision is undeniable, and though the tendency of enlightened modern jurists is unmistakably towards it, the courts have not as yet followed it for it will mean, if this view gains ground, and the courts consequently go this far, that the question of want of corporate power, just like the question of legality of corporate organization can only be raised by the sovereign State, and that if the State is satisfied with the interpretation of the charter adopted by the corporation, and manifests its acquiescence by not prosecuting the corporation,
and that if no question of public policy is involved no reason would be apparent why a third party who has actually dealt with the corporation should be allowed to raise the issue of corporate capacity.

The champions of what is called the strict or Federal rule are chiefly the Illinois and the Federal courts. This rule makes all contracts which are foreign to the nature and design of the corporation, and which are hence beyond the powers conferred upon the corporation, and therefore ultra vires and not enforceable but wholly void and of no legal effect whatever, and prohibits the performance of an ultra vires contract and receipt of benefits thereunder from working an estoppel, the effect of which would be the precluding of the defendant from setting up the invalidity of the contract. Thus in the Federal case of Westerlund vs. the Black Bear Mining Company, 203 fed. 599, it was said “A contract of a corporation which is beyond the scope of its corporate powers, which it cannot lawfully do in any way or manner, under any circumstances, is void and incapable of ratification by estoppel or otherwise, and the corporation itself may challenge it.” The courts make a distinction between contracts which are ultra vires merely because of the disregard of mere formalities which the law requires to be observed, and those which are for want of power in the corporation, and hold that the former can be enforced while the latter cannot be under any circumstances. On this particular distinction, the Illinois court in the case of Stacy vs. the Glen Ellyn Hotel and Springs Company, 79, N.E. 133, gave expression to the following opinion: “Where a corporation is acting within the general scope of the powers conferred upon it by the legislature the corporation as well as persons contracting with it may be estopped to deny that it has complied with the legal formalities which are prerequisites to its existence or to its action because such prerequisites might in fact have been complied with; but where the contract is beyond the powers conferred upon it by existing laws neither the corporation nor the other party to the contract can be estopped to show that it was prohibited by those laws by consenting to it or acting upon it.” Justice Gray of the United States Supreme Court, whom we have previously quoted, in the opinion delivered in the
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case of the Central Transportation Company vs. the Pullman Palace Car Company, 11 S.C.R. 478, clearly states the position which the courts take which follow the strict or Federal rule in regard to contracts that are ultra vires in the sense that they are beyond the scope of the powers of the corporation, when he says: "A contract of a corporation which is ultra vires in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization and therefore beyond the powers conferred upon it by the legislature is, not voidable only, but wholly void and of no legal effect. The objection to the contract is not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity or be the foundation of any right of action upon it," and in the course of the same opinion he gave his reasons which justify courts in refusing to hold corporations liable on such contracts, which reasons are identically the same as those he gave in the earlier case which we have previously cited and from which we quoted in the first part of our treatment of this class of contracts: "All contracts made by a corporation beyond the scope of their powers are unlawful and void, and no action can be maintained upon them, and this upon three distinct grounds: 1, The obligation of everyone contracting with a corporation to take notice of the legal limits chargeable at law with notice of the want of power. Where the corporation has been held to be estopped has been where the act complained of was within the general scope of the corporate powers," and the same court in the later case of Steele vs. the Fraternal Tribunes, 74 N.E. 121, said, "A contract ultra vires is unenforceable though it has been in good faith performed by one of the parties, and the corporation has had full benefit of the performance." The Tennessee court in the case of Miller vs. the American Mutual Accident Insurance Company, 21 S.W. 39, gave utterance to the following opinion: "The fact that a corporation has received benefits of a contract which was ultra vires does not justify an enforcement of the contract but the remedy is a suit in disaffirmance and for an accounting. The true foundation of the doctrine
of ultra vires lies in the proposition that every act of a corporation in excess of its powers is an act in contravention of public policy, and for that reason to be held null and void. All acts outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it, are acts not voidable only but wholly void. "Thus in the case of the Best Brewing Company vs. Klassen 57 N.E. 20, where a corporation without power to do so enters into a contract guaranty or suretyship, the plea of ultra vires is a complete defense to its enforcement against the corporation, and also as in the case of the National Home Building and Loan Association vs. the Home Savings Bank, 54 N.E. 619, where a corporation without power to purchase real estate, purchases real estate subject to a mortgage and expressly assumes the mortgage, it may defend against liability on such assumption under a plea of ultra vires. Still another example of the application of this rule which we are now discussing is to be found in the case of the California National Bank vs. Kennedy 17 S.C.R. 831, where a national bank purchased stock of another corporation, which purchase was not incidental to the banking business and subsequently received dividends on the stock, the bank could defend against its liability for the debts of such corporation on the ground of ultra vires, for since the purchase is void it could not be ratified and the bank could not thereby be estopped to make such denial. But in the application of this strict rule of ultra vires the fact must not be lost sight of that in exercising the powers conferred upon it a corporation may adopt any proper and convenient means tending directly to their accomplishment and not amounting to the transaction of a separate unauthorized business. As will be remembered, Justice Gray of the Federal Supreme court established as one of the reasons why a corporation is not liable upon a contract ultra vires is the obligation of everyone entering into a contract with a corporation to take notice of the legal limits of its powers. Where a corporation is created and its powers conferred by a public act a man who enters into a contract with it which is clearly in excess of its powers as shown by the act cannot enforce the contract for he is chargeable with knowledge of public laws and, therefore, of the powers of the corpora-
tion. So, consequently, the courts which have accepted and followed this strict rule governing ultra vires contracts have charged every person dealing with a corporation with notice of the limitations of its powers, and have held that such persons cannot plead ignorance of the ultra vires character of the transaction. The Illinois court in the case of Steel vs. the Fraternal Tribunes 74 N.E. 121, stated the proposition of notice as follows: “Powers delegated by the State to corporations are matters of public law of which no one can plead ignorance. A party dealing with a corporation having limited and delegated powers is chargeable with notice of those powers and their limitations and cannot plead his ignorance.” Since the charter is the law of corporate existence every corporation necessarily carries its charter wherever it goes, and every person who deals with it, anywhere, is bound to take notice of the provisions which have been made in its charter. Thus where a corporation, not being authorized by its charter, enters into a contract of guaranty or suretyship, this is clearly in excess of its powers, and the other party is chargeable with knowledge of this fact and cannot hold it liable, and this identical point was upheld by the Iowa court in the case of Lucas vs. the White Line Transfer Company, 30 N.W. 771. Having seen what the attitude of the courts is which have logically applied with almost, but not quite, perfect consistency this strict rule of ultra vires, the question naturally presents itself as to what lengths have these same courts gone in allowing either the corporation or the other contracting party to retain, after putting up the shield of ultra vires and thereby defending an enforcement of the ultra vires contracts, the benefits received under such contract without making restitution or compensation therefor to the other party. Fortunately, these courts recognize the fact that the obligation to do justice rests upon all persons, natural and artificial, and that if one obtains the money or property of another, without authority to do so, the law, independent of express contract will compel restitution or compensation. Justice Gray of the United States Supreme court in the case of the Central Transportation Co. vs. the Pullman Palace Car Company, 11 S.C. R. 478, pointed out the way in which justice could be done between the parties to an ultra vires contract
without enforcing such a contract, when he used the following language: "A contract ultra vires being unlawful and void, not because it is in itself immoral, but because the corporation by the law of its creation is incapable of making it, the courts while refusing to maintain any action upon the unlawful contract have always striven to do justice between the parties so far as could be done consistently with adherence to law, by permitting property or money parted with on the faith of the unlawful contract to be recovered back or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract nor according to its terms, but on an implied contract of the defendant to return, or failing to do that to make compensation for property or money which it has no right to retain. To maintain such an action is not to affirm but to disaffirm the unlawful contract." In the later case of *Earling vs. Emigh* 30 S.C.R. 672, Justice White of the same court affirmed the position taken in regard to the principle involved in the foregoing opinion, and now under discussion, when he said: "Altho restitution of property obtained under a contract which was illegal because ultra vires cannot be adjudged by force of the illegal contract, yet as the obligation to do justice rests upon all persons, natural and artificial, if one obtains the money or property of others without authority, the law independently of express contract will compel restitution or compensation." The Illinois courts, like those of the other states which accept and follow the strict or Federal rule in regard to ultra vires contracts, have adopted the principles laid down by the United States Supreme court as to the doing of justice without resort to the ultra vires contract, and in the case of the *United States Brewing Company vs. Dolese and Shepard Company*, 102 N.E. 753, the Illinois court had this to say: "Although a party is not liable to pay according to a contract which is ultra vires, that fact is not permitted to work injustice where the law can afford a remedy without enforcing the illegal contract, and the courts will give relief where it can be given independent of the contract. It would be unjust to hold that one who has received money or property under a contract which is ultra vires need not account for it because the contract was ultra vires, but the law implies a contract to
return what has been received. Where a contract is not malum in se or malum prohibitum, and it has been executed or benefits have been received, the party benefited, whether the corporation or an individual, will not be permitted to retain the fruits of the transaction without compensation. Where a contract is ultra vires and a corporation has received money under it which in equity and good conscience belongs to another and which it ought to pay over, it is liable for it in an action for money had and received with interest after demand. An action for the recovery of the money would not enforce or affirm the original contract but would disaffirm it. From the foregoing opinions which have been expressed by eminent jurists, it would be reasonably safe to draw the conclusion that a recovery on a quantum meruit for the benefits received under the contract is allowed not only against the corporation where it has received benefits through the performance by the other party, but also by the corporation as to which the contract was ultra vires against the other party who received the benefits through the performance by the corporation, for it would be in the highest degree inequitable and unjust to permit such a thing to ever come about. So if a corporation has received money or property or the benefit of services under an ultra vires contract the courts are virtually agreed that it may be compelled to refund the value of that which it has actually received in an action quasi ex contractu, or, in a proper case in a suit for an accounting. The limitation of the contractual power of a corporation does not prevent it from making restitution of money or property obtained under an unauthorized contract. Thus, where a corporation enters into an ultra vires contract to purchase merchandise for speculation, and the contract is partly performed by the seller he may recover on a quantum meruit for the merchandise delivered though he refuses further to perform the contract, and the corporation cannot recover damages for the refusal further to perform, and in just such a case the Michigan Court in Day vs. the Spiral Springs Buggy Company 23 N.W. 628, said: "It is to be observed that the contract, though void in law, involved no element of criminality and nothing of an immoral nature. The case is not, therefore, one in which the law will leave the parties without redress for the conse-
quences of criminal or immoral action." Moreover, if the other party to the ultra vires contract has received benefits from the corporation under the contract the corporation may recover back the reasonable value of such benefits in quasi contract. Thus in the Illinois case of the United States Brewing Company vs. the Dolese and Shepard Company 102 N.E. 753a, brewing corporation made an ultra vires contract by which it took a lease of real property agreeing to construct and maintain thereon a building for a saloon and boarding house; the lease providing that should the district within which the premises were located become prohibition or local option within three years the lessor should pay the corporation the cost price of the improvements, and within the specified period the district became prohibition territory, and the court held that since such contract, though ultra vires, was neither immoral nor contrary to public policy, the corporation, though not entitled to enforce the contract, was nevertheless entitled to recover the reasonable value of the building erected.

However, the difference is looked upon by many courts with disfavor wherever it is presented for the purpose of avoiding an obligation which a corporation has assumed merely in excess of the powers conferred upon it, and which is otherwise legal and equitable and not in violation of some express prohibition of the statutes; and in the modern case especially the rule has been frequently announced that the plea of ultra vires should not be allowed to prevail, whether interposed in behalf of or against a corporation, when it will not advance justice, but, on the contrary, will accomplish a legal wrong. In many jurisdictions the plea of ultra vires is looked on with such disfavor that the rule seems to prevail that if the corporation has received the benefits growing out of a contract such contract will be enforced against it unless it was entered into through fraud or there are persuasive considerations of public policy involved, and this is commonly known as the prevailing rule. According to this rule which is followed by many courts which it must be acknowledged are in the majority, a recovery directly upon the contract is permitted on the ground that the corporation having received money or property or services by virtue of a contract not immoral or illegal of itself is estopped to
deny liability, and the only remedy is one on behalf of the State to punish the corporation for violating the law. The reasons supporting the doctrine allowing a recovery on an ultra vires contract itself are clearly set out in the following cases from which it would be well to quote portions of the opinions rendered therein. In the case of the Zinc Carbonate Company vs. the First National Bank, 79 N.W. 229, the Wisconsin court gave voice to the following: “If a corporation obtains a wrongful advantage of another in regard to a transaction outside its corporate powers, it cannot shield itself from liability to remedy the wrong by the doctrine of ultra vires. Ordinarily, as to executed matters, the doctrine of ultra vires is an instrument to be used only by the State to punish a corporation for violating its charter, not by the corporation itself nor an individual to aid in the perpetrating or perpetuating of a wrong. The doctrine of ultra vires is a most powerful weapon to keep private corporations within their legitimate sphere, and to punish them for violations of their corporate charters, and it probably is not invoked too often; but to place the power in the hands of the corporation itself or a private individual to be used by it or him as a means of obtaining or retaining something of value which belongs to another would turn an instrument intended to effect justice between the State and the Corporation into one of fraud as between the latter innocent parties.” The Indiana court in the leading case of Wright vs. Hughes 119 Ind. 324, said: “Like natural persons corporations must be held to the observance of the recognized principles of common honesty and good faith, and these principles render the doctrine of ultra vires unavailing when its application would accomplish an unjust end or result in the perpetration of a legal fraud. After a corporation has received the fruits which grow out of the performance of an act ultra vires, and the mischief has all been accomplished, it comes with an ill grace then to assert its want of power to do the act or make the contract in order to escape the performance of an obligation it has assumed. Where a contract has been executed and fully performed on the part of the corporation or of the party with whom it contracted neither will be permitted to insist that the contract was not within the powers of the corporation.” The Michigan court
is of the same opinion as is shown by the case of Blackwood vs. the Lansing Chamber of Commerce, 144 N.W. 823, for in that case this particular court said: "Except in cases where the rights of the public are involved the plea of ultra vires, whether interposed for or against a corporation, will not be allowed to prevail when it will not advance justice, but will accomplish a legal wrong. The great mass of judicial authority seems to be to the effect that where a private corporation has entered into a contract in excess of its granted powers, and has received the fruits or benefits of the contract and an action brought against it to enforce the obligation on its part, it is estopped from setting up the defense that it had no power to make it." From this it seems that in those states in which this relaxed rule of ultra vires prevails, the law never sustains the defense of ultra vires out of regard for the corporation, and in the cases where it does so the most persuasive considerations of public policy are involved. But this rule is never applied to ultra vires contracts which are executory on both sides for, as we have seen, they cannot in such instances be enforced, nor to such contracts so executed as to both parties for, as will be remembered, courts refuse to undo what has been done in such cases. Nor has the rule any application to those cases where the contract by statute or contrary to public policy, or otherwise in contravention of law, for in the language of the Indiana court in the case of the Franklin National Bank vs. Whitehead 149 Ind. 560 "The doctrine that where a corporation enters into a contract merely beyond its powers, which if made by a private person would have been binding upon him, and such contract has been performed by the other party thereto, the corporation will not be permitted to deny its powers to make such contract, does not apply to contracts that are forbidden by statute or are contrary to public policy. The only cases to which this rule is applicable are those where the contract has been fully performed or executed on one side only, and either party has received benefits under the contract in the form of money, property or service. Thus where one has bought property from a corporation and is sued for the price he cannot set up in defense that the corporation had no power to buy and sell the property, and as the New York court held in the case of
the Holmes and Griggs Manufacturing Company vs. the Holmes and Wessell Metal Company, 27 N.E. 831. So also where a street railway company, as was done in the Indiana case of the State Board of Agriculture vs. the Citizens Street Railway Company, 47 Ind. 407, agreed to pay a certain sum if the State Board of Agriculture would hold the state fair at a certain place, and the fair was held at the place agreed upon and the street railway company had had the benefit therefrom in its increased traffic, it was held that the company could not subsequently set up the defense of ultra vires to defeat liability on its contract. And likewise, where a corporation contracted to pay a certain person a commission for securing a factory site for it, and this site he later actually acquired, although the contract was in excess of the charter powers of the defendant, it was held by the Indiana court, in the case of the Seamless Pressed Steel and Manufacturing Company vs. Monroe 57 Ind. App. 136, in which similar facts were presented, that since the corporation had received a benefit under the contract, it could not, when sued thereon, set up ultra vires as a defense thereto. Still another striking example is to be found in the Michigan case of Blackwood vs. the Lansing Chamber of Commerce 144 N.W. 828, where an incorporated Chamber of Commerce contracted in good faith for the holding of a Chautauqua meeting, and the contract was carried out by the other party thereto, in view of the fact that there was nothing against public policy in promoting a Chautauqua. the defense of ultra vires was not allowed to prevail. From the illustrations of the applications of this relaxed rule of ultra vires there can be drawn the following conclusion which can be safely stated as a general rule in those jurisdictions which allow recovery directly on the ultra vires contract: Where the making of the contract is merely beyond the power of the corporation, but it has by its promise induced the other party to perform his part of the contract, so that upon failure of the corporation to perform its part the parties will not be left in their previous situation, and the corporation has received benefit from the performance of the other party, the corporation will be held liable upon the contract. But the right of action is not limited to the other party to the contract. If the corporation has per-
formed its part of the contract it may maintain an action too. Where the contract has been in good faith fully performed by the other party, and the corporation has had the full benefit of the performance and of the contract, the corporation cannot avail itself of the defense of ultra vires. The same rule can be conversely stated, and then it would have the same force and effect. If the other party to the contract has had the benefit of a contract fully performed by the corporation, the law will not permit him to relieve himself from liability on the ground that the contract and performance were not within the legitimate powers of the corporation. To render this doctrine applicable, the benefits received must have come from the other party to the contract. In other words, the courts which have adopted this prevailing rule require that there shall have been some performance on the part of the plaintiff which will render it unjust and inequitable, and contrary to the first principles of equity and justice to permit the defendant to set up the ultra vires character of the contract in defense for if there has been no performance no injustice would result from a refusal to lend aid in enforcing an ultra vires contract. As was said in the Iowa case of the Marshalltown Stone Company vs. the Des Moines Brick Manufacturing Company, 126 N.W. 190, "Where a private corporation has entered into a contract in excess of its general powers, and has received the benefit thereof, it is estopped from setting up the defense in an action to enforce performance on its part that it was without power to make the contract. An examination of the cases supporting this relaxed rule of ultra vires will show that the foundation upon which the doctrine is said to rest is generally that of an equitable estoppel. In this connection the Colorado court in the case of the Denver Fire Insurance Company vs. McClelland, 9 Pac. 771, expressed the following opinion: "We are aware that the courts have been very slow to concede that a defendant setting up, as a defense, the ultra vires of a contract, where said contract was clearly not authorized, should be held liable on the contract, since this would appear to sustain the enforcement of an unauthorized contract, and, therefore, the cases show that whenever the courts would avoid this seeming inconsistency by resting the recovery upon some other
ground they have done so. This has often led to equal inconsistency in other directions. The true ground would seem to be that of equitable estoppel whereby the defendant is not permitted to rely upon or show the invalidity of a contract. In such case the contract is assumed by the court to be valid; the party seeking to avoid it not being permitted to attack its character in this respect.” But, as we have seen before, a person dealing with a corporation is charged with notice of the limitations of its powers, and for this reason it is not easy to raise an estoppel in his favor. But the Indiana Appellate court in the case of Voris vs. the Star City Building and Loan Association, 20 Ind. App. 680, said “One who deals with a corporation is presumed to know its powers and the limitations of its authority, and hence is estopped to plead its want of authority.” When the necessity arises for raising an estoppel in favor of the corporation which could not have been misled by the other party to the ultra vires contract in respect to its own powers, it is found still more difficult to do so than it is in the case of the other party to the contract. The use of the term “estoppel” in this respect has been criticized for the foregoing reasons. The Kansas court in Harris vs. the Independence Gas Company, 92 Pac. 1123, seeking to find an excuse for the application of the doctrine of estoppel to ultra vires contracts gallantly defended this use of the term in the following language: “It is argued that as a corporation must know the terms of its own charter, and as one dealing with it is charged with like knowledge, neither party to an ultra vires contract can be misled in that respect, and, therefore, there must always be lacking an essential element of what could with technical accuracy be called estoppel. This, however, is a mere question of terminology. The requirement that one shall be consistent in conduct—shall not occupy contradictory positions—shall not retain the advantages of a transaction and reject its burdens—is often spoken of as a form of estoppel. The term is convenient, and if inaccurate is not misleading. This rule of estoppel affords a good working hypothesis to accomplish just results.” From this, it seems that for want of a better foundation upon which to rest this doctrine of allowing recovery on ultra vires contracts, the courts following this prevailing
rule have adopted and endeavored to consistently apply the equitable doctrine of estoppel. The reasons by which the courts have been influenced are not so much those of equitable estoppel as they are those arising from the development of the close relationship existing today between corporations and individuals. These reasons which are quite obvious were recognized in the early New York case of Bissell vs. the Michigan Southern and N. I. Railroad Company, 22 N. Y. 259, in which the Chief Justice said: “Commercial manufacturing and trading corporations are brought into relation with almost every member of the community, and I think it greatly to be desired that in laying down the rules of law which are to govern in such relations we should avoid a system of destructive technicalities. Those rules should be founded on the principles of justice which are recognized in other and analogous dealings among men.” The Indiana court must have certainly had these reasons in mind when it said, in substance, that it would be carrying the doctrine concerning ultra vires contracts to an unwarranted extent to hold that a corporation might obtain the money of another, and with the fruits of the contract in its treasury interpose the defense of ultra vires. As we have previously seen, the rule requiring the observance of good faith and fair dealing is as applicable to corporations as to individuals. Neither can involve others in onerous engagements, and with the consideration of the contract in their possession disavow their acts to the damage and discomfiture of others, unless it clearly appears that there was an absolute want of capacity to make the contract. In the administration of justice the promotion of public policy is one of the goals aimed at by the courts and public policy is promoted by the discouragement of fraud and the maintenance of the obligation of contracts. In the well considered case of Wright vs. Hughes, 119 Ind. 324 the Indiana court gave voice to the following which has found favor in the courts of other states: “Like natural persons, corporations must be held to the observance of the recognized principles of common honesty and good faith, and these principles render the doctrine of ultra vires unavailing, when its application would accomplish an unjust end or result in the perpetration of a legal fraud. After a corporation has received the fruits which
grow out of the performance of an act ultra vires, and the mischief has all been accomplished it comes with an ill grace to assert its want of power to do the act or make the contract in order to escape the performance of an obligation it has assumed." So when a contract by a private corporation which is otherwise unobjectionable has been performed on one side, the party which has received and retained the benefits of such performance shall not be permitted to evade performance on the ground that the contract was in excess of the purposes for which the corporation was created. There are few rules better settled or more strongly supported by authorities, with fewer exceptions, in this country, than that just stated which, though it may not be what one would call strictly logical, prevents a great deal of injustice.

Having seen the divergence of opinion which has arisen adjudications in some of the courts, and which has been the source of the two doctrines concerning the ultra vires contracts of corporations, it would be no more than natural for us to seek more light on this subject and by comparing the strict or Federal rule and the prevailing rule see wherein they are different, and wherein they are alike. The two great points of difference are: 1, the effect of the execution of the contract by one of the contracting parties, whether the party be the corporation or the individual, upon the right of him so performing to invoke the aid of the court in enforcing the contract; and 2, the nature of the action in which recovery is sought and allowed when the contract has been fully performed on one side and either party has received benefits under the contract. The strict, or Federal, rule is that the incurring of expenses, or the sustaining of losses, or even full performance on the part of one of the contracting parties, does not render the other one liable on the contract itself for the contract being wholly null and void cannot be made the foundation of an action by either party. The prevailing rule, which is the very opposite of the Federal rule, allows a recovery on the ultra vires contract itself, if such contract is objectionable merely because it is in excess of the powers conferred upon the corporation by its charter, not being otherwise contrary to law, and it has been so far performed or acted upon by one of the parties that it would be inequitable and unjust to hold the contract void. The
courts adopting and following the strict Federal rule refuse to permit the retention of money or property received under an ultra vires contract, and so they allow actions quasi ex contractu in disaffirmance of the contract to be maintained, while the courts adopting and following the relaxed prevailing rule do not resort to such subterfuges in order to do justice between the parties by allowing actions quasi ex contractu—actions not on the express contract itself but on an implied contract to be maintained. But instead, they come out in the open and allow actions ex contractu—actions on the very contracts themselves—to be maintained. In this respect the difference is not so much in the results sought and obtained as it is in the methods used to reach and obtain those results. The difference is to be found in the theories of the various actions made use of in obtaining relief under partly performed ultra vires contracts. The courts adopting the strict or Federal rule indirectly do what the other courts adopting the relaxed prevailing rule directly do, and obtain practically the same results that the latter courts obtain. In the former courts the actions are maintained on the theory of implied contract, while in the latter the actions are based on the express contracts themselves. So this particular difference lies in the means used to reach the end sought, which is practically the same in all cases.

According to what would seem the more logical view, which it must be admitted is not one in which justice is the guiding star, a corporation, though it has received the benefits of a strictly ultra vires contract, is not estopped to set up the defense of ultra vires when sued upon the contract, though it is universally recognized that a recovery may, at least, be had on a quantum meruit for the benefits received by the corporation. So in accordance with this view, which we have seen has been taken by one line of cases—those in which there has been an application of the strict or Federal rule—a recovery directly upon an ultra vires contract is denied, though there has been a performance by the party seeking to enforce the contract on the ground that the contract is void, and no act of either party can give it any validity. Still, the courts adopting this view, which it must be confessed are in the minority, have always striven to do justice between the parties so far as could be done consis-
tently with adherence to law, by permitting property or money parted with on the faith of the unlawful contract to be recovered back or compensation to be made for it. In such case the action is not maintained upon the unlawful contract, nor according to its terms, but on an implied contract of the defendant to return, or failing to do that to make compensation for property or money which it had no right to retain. To maintain such an action is not to affirm but to disaffirm the unlawful contract. On the other hand, according to the view taken by the other courts, which are those following the relaxed prevailing rule, and which it must be admitted are in the majority, a recovery directly upon the contract is permitted on the ground that the corporation having received money or property by virtue of a contract not immoral or illegal of itself, is estopped to deny liability, for these courts look upon the defense of ultra vires with disfavor whenever it is presented for the purpose of avoiding an obligation which a corporation has assumed merely in excess of the powers conferred upon it and not in violation of some express provision of the statute, and, as has been frequently announced in the modern cases, the plea of ultra vires should not be allowed to prevail, whether interposed for or against a corporation, when it will not advance justice, but on the contrary, will accomplish a legal wrong. The doctrine allowing a recovery on an ultra vires contract is the better doctrine, and has the support of the great weight of decision. The want of authority may render a contract void, but the mere want of authority, without more, does not render a contract illegal, so that it can, under no circumstances, give rise to an action. Contracts are illegal either in respect to the consideration or the promise. A promise by an individual founded on a lawful consideration to do that which in itself is lawful to be done is legal. A similar promise by a corporation is just as legal, although the transaction contemplated is not within the powers granted by its charter, and therefore ultra vires, and there is no good valid reason why causes of action may not arise out of it. For these reasons, if for no other, the prevailing rule should be given the preference over the strict or Federal rule when the question comes before a court as to which one it shall adopt and follow.
It would be well for us, before we leave the subject, to see whether there is a presumption of ultra vires or not. It may be safely accepted as a general proposition that there is no presumption that a corporation has exceeded its powers, for the presumption is never to be indulged in that parties in making their contracts intended to violate the law, and furthermore the law presumes in favor of a contract and not against it. Therefore, the defense of ultra vires must be pleaded. The Kentucky court in the comparatively recent case of Martin vs. the Kentucky Lands Investment Company, 142 S.W. 1038, held that there is no presumption that a corporation has exceeded its powers, but ultra vires is a matter to be pleaded as a defense, and the Michigan court in Blackwood vs. the Lansing Chamber of Commerce 144 N.W. 823, was of the same opinion when it said that the defense of ultra vires is a special defense not available under the general issue but must be specially pleaded. So it would be consistent with sound legal principles to plead ultra vires should the occasion arise where such fact would be a good defense, and moreover such fact should be pleaded in that event.