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The Ultra Vires Doctrine in Corporate Law

A Comparative Review

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Marco Antonio Jiménez Sánchez
Universidad Militar Nueva Granada
Bogotá, Colombia

ISSN 2192-855X ISSN 2192-8568 (electronic)
SpringerBriefs in Law
ISBN 978-3-030-88837-4 ISBN 978-3-030-88838-1 (eBook)
https://doi.org/10.1007/978-3-030-88838-1

This Springer imprint is published by the registered company Springer Nature Switzerland AG
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

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Abbreviations

ADHGB	Allgemeines Deutsche Handelsgesetzbuch
AG	Aktiengesellschaft
AktG	Aktiengesetz
art.	Article
bG	Bergrechtliche Gewerkschaft
BGB	Bürgerliches Gesetzbuch
C.C.	Civil Code
C.Co.	Commercial Code
CA	Companies Act
Cf.	Confer
Ch.	Chapter
CJI	Inter-American Juridical Committee
Coord.	Coordinador
e.g.	Exempli gratia (for example)
EC	European Community
EEC	European Economic Community
et al.	Et alia (and others)
et seq.	Et sequentes (and what follows)
etc.	Et cetera (and the others)
EU	European Union
GmbH	Gesellschaft mit beschränkter Haftung
GmbHG	Gesetz betreffend die Gesellschaften mit beschränkter Haftung
HGB	Handelsgesetzbuch
i.e.	Id est (that is)
Ibid.	Ibidem (in the same place)
In re	In the matter of
J.	Journal
L.	Law
Lit.	Literal
Ltda.	Sociedad de Responsabilidad Limitada
MBCA	Model Business Corporation Act

MGLC	Mexican General Law of Corporations of 1934
Nat'l	National
Num.	Numeral
OAS	Organization of American States
op. cit.	Opere citato (the work cited)
par.	Paragraph
Pt.	Part
Q.	Quarterly
Rev.	Review
s.	Section
S.A.	Sociedad Anónima
SAS	Société par Actions Simplifiée
SE	Societas Europaea
SPA	Società per Azioni
SRL	Società a Responsabilità Limitata
t.	Tome
tit.	Title
UCC	Uniform Commercial Code
UK	United Kingdom
UNCITRAL	United Nations Commission on International Trade Law
USA	United States of America
Vid.	Vide (see)
Vol.	Volume
Vs.	Versus (against)

Chapter 1
What Is the Ultra Vires Doctrine?

Abstract In this chapter, we do address two issues. Firstly, we answer the question: What is the ultra vires doctrine? In doing so, an explanation of the meaning in corporate law is delivered taking as the starting point the capacity as an attribute of the corporate personality. On the other hand, a brief description of this book's contents is outlined. That way we present the three main thematic axes, which are split up into nine chapters.

1.1 Introduction: What Is the Ultra Vires Doctrine?

According to Black's Law Dictionary ultra vires means: "Unauthorized; beyond the scope of power allowed or granted by a corporate charter or by law".[1] Nevertheless, Machen delivered the following definition: "In its proper sense, it [ultra vires] denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined by the statutes under which it is formed or which apply to it, or by its charter or incorporation paper".[2] There is also a division among authorities regarding the use of the phrase ultra vires to describe acts that are illegal in the sense of being *malum per se* and *malum prohibitum*. It seems that it would be better to use these words to describe only such contracts of corporations exceeding their corporate powers.[3]

[1] Garner (2009), p. 1662.

[2] Machen (1908), p. 819. The expression "ultra vires" had already been used by ancient equity scholars in the field of contract law, a long time ago before it was applied to the law of corporations. For instance, "(…) a *bona fide* transaction with a putative proprietor. Such transaction is void at common law as ultra vires; and were there no remedy in equity, the paying debt to a putative creditor would not be more hazardous, than transactions with a putative proprietor. (…)". Cf. Kames (1825), p. 350.

[3] Elliott (1911) §200. However, in Central Transportation Co. v. Pullman Palace Car Co., 139 U.S. 24 (1890) the Court emphasized that: "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

M. A. Jiménez Sánchez, *The Ultra Vires Doctrine in Corporate Law*,
SpringerBriefs in Law, https://doi.org/10.1007/978-3-030-88838-1_1

It is correct to assert that ultra vires acts or transactions do not necessarily involve either unlawful or illegal behavior. The act or transaction could be performed by the company because it is in their ambit of competency or business field, but such power to execute or to get involved in the particular affair was not contemplated at the time of the foundation.[4] To sum up this introductory approach: "The doctrine of ultra vires is, that all acts of a corporation, not within the powers conferred upon it by its charter, or the statutes under which it was instituted, or reasonably implied therefrom, are null and void, and as to such acts the corporation may be restrained in equity by an injunction, or it may set up the plea of ultra vires as a defense to an action at law (…) The question whether a particular act of a corporation is ultra vires is determined by a construction of its constating instruments. If the act is prohibited, or against public policy, it is not ultra vires, it is illegal".[5]

Because of this, it is equivocal to hold that in the case of a stock exchange trader who negotiates non-existent securities on behalf of the corporation, that it would thereby be viable to file a suit against the firm due to such an illegal ultra vires act committed by one of their subordinates.[6] Under this hypothesis, there is no room for the ultra vires doctrine, and neither can there be an assertion that such behavior is an exception to an ultra vires act because the corporation cannot plea the ineffectiveness of the acts performed by their employees beyond the limits of the granted powers. In this case, an action at law could be raised on the grounds of a tort.

The ultra vires doctrine is principally concerned with corporations only pursuing the purposes for which they were created, and any kind of act or transaction beyond that point becomes ultra vires, and consequently, void. In other words, if the corporation tries to effect purposes other than those for which it was created, its acts or transactions will be ultra vires and void. Another subsequent variant of the doctrine

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void and of no legal effect (…) 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 (…)". According to this line of authority, a distinction must be made: the contracts which are merely unauthorized by the corporate charter are ultra vires, and contracts that are illegal because they are contrary to law, are both ultra vires and illegal.

[4] Nevertheless, at an early stage of the ultra vires doctrine, British courts held in Bagshaw v. Eastern Union Ry. (1850) 2. M. & G. 389: "The Legislature may have thought it right to provide that the capital raised for a specific purpose should not be applied for any other purpose. Under such a state of things, the application of capital so appropriated to any other than the specified purpose must be *unlawful*. No majority of the shareholders, however large, could sanction the misapplication of such a portion of the capital. Indeed, in strictness, even unanimity would not make such an act lawful" (italics added).

In accordance with the opinion of the United States Supreme Court Justice Gray, everybody who deals with a corporation is charged with constructive notice of its powers. An ultra vires act is an illegal act. Therefore A, when he participated in the act, was *particeps criminis*. In re St. Louis Railroad v. Terre Haute Railroad, 145 U.S. 393. See, Warren (1910), p. 507. We are adherents to Professor Warren who claims that this is a ferocious doctrine. Unauthorized corporate action, simply because it is unauthorized, cannot with any propriety be said to be criminal. It is not even illegal if that adjective is used to connote something particularly reprehensible, and not simply to connote something contrary to law. Ibid.

[5] Swaney (1883), p. 2.

[6] Martínez (2007), p. 39, et seq.

teaches that the company's directors have confined powers granted in the articles of association and legal provisions. Therefore, when the directors perform an act or transaction for which they do not have authority, for example, hiring a lawyer or exceeding the power granted them as such to get a bank loan for an amount of money above and beyond what the company's recorded articles of incorporation authorize them to borrow,[7] both become ultra vires.[8] In this writing, we will use the word *director* in its broadest sense to mean any kind of individual, who has been designated by law or appointed by the stockholders to exercise the firm's management.[9]

Ballantine notices that the ultra vires doctrine had its origin in a judicial deduction from the fictional conception of corporations as artificial persons, creatures of the law, which have no existence, powers, or capacity except those granted by statute.[10] Hence a contract made in the name of the corporation for purposes not included in the articles, although by the authority of all the directors, and even with the consent of all the stockholders, has been held by some courts to be unattributable to the corporation at all. The earlier English cases originating the ultra vires doctrine were cases where the only parties concerned were stockholders and the corporation, holding that a minority could restrain the firm from acting outside the purposes provided for. In 1860, the doctrine was extended to relations with third parties. By this extension, it became possible for corporations to evade liability to an irksome contract by showing their actual incapacity to even make the contract.[11]

The ultra vires doctrine has an intimate connection to the company's capacity as an attribute of its personality.[12] Through it, the firms can interact in litigation

[7] Elliott (1911) §212, footnote 48. In this case, the bank can collect only the amount, which the corporation is thus authorized to contract indebtedness for. In re First Nat. Bank V. Kiefer Milling Co., 95 Ky. 97, 23 S. W. 675, 15 Ky. L. 457; First Nat. Bank v. American Nat. Bank, 173 Mo. 153, 72 S. W. 1059; Monument Nat. Bank v. Globe Works, 101 Mass. 57, 3 Am. 322; Lyon, etc., Co. v. First Nat. Bank, 85 Fed. 120, 29 C. C. A. 45; Connecticut River Say. Bank v. Fiske, 60 N. H. 363; Prospect Worsted Mill, 126 Fed. 1011.

[8] Comparative law scholars such as Pistor (2002), p. 818, claims that directors overstepping the established boundaries were acting ultra vires. Then, transactions ultra vires were null and void and directors could be held personally responsible. The success of the ultra vires doctrine as an instrument to control management has had mixed results.

[9] For example, in Colombia the Law 222 of 1995, art. 22, conceived a broad concept of *managers*. Accordingly, the representatives, liquidators, factors, members of the board of directors, and in general anyone that according to the articles of incorporation holds the inherent duties to those positions, are considered as *directors*. In the opinion of the Minister of Justice and the Superintendence of Companies, this is a restrictive enumeration because both the punishable regime and liability involved cannot apply to those individuals not listed in such provision. Therefore, it is not allowed to make an extensive interpretation. Cf. Ministerio de Justicia (1998), p. 143.

[10] Ballantine (1930), pp. 235, 238.

[11] Ballantine (1930), pp. 235, 238.

[12] Geldart (1927), p. 104, holds that to say that all legal personality (natural or juristic) is equally real because the law gives it an existence, and equally artificial or fictitious because it is only the law which gives it an existence, is really confounding *personality* with *capacity*. Despite this author not pointing out the difference between these two legal concepts (personality/capacity) there is a gender to species ratio. The *capacity* is an attribute of the *personality* through which a natural individual or juristic person such as a corporation, may enforce the fulfillment of an obligation or exercise