THE DOCTRINE OF ULTRA VIRES:

CURRENT PROBLEMS AND SUGGESTED REFORMS

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TABLE OF CONTENTS

		PAGE NO.
A.	INTRODUCTION.	1
B.	HISTORY OF THE ULTRA VIRES DOCTRINE . . .	2
	(1) Definitions	2
	(2) Origin.	3
	(3) Current Alberta Practice.	4
	(4) Extra-Provincial Capacity	5
C.	THE RATIONALE OF THE ULTRA VIRES DOCTRINE.	6
	(1) Unacceptable Rationales	6
	(2) Acceptable Rationales	7
D.	HOW EFFECTIVE IS THE ULTRA VIRES DOCTRINE	9
	(1) Introduction.	9
	(2) Protecting the Interests of Third Parties	9
	(a) Debtors	10
	(b) Creditors	11
	(i) Intra Vires Creditors, , , ,	11
	(ii) Ultra Vires creditors. . . .	12
	(c) Other Areas	14
	(i) Tort and Crime	14
	(ii) Remedies	14
	(3) Protecting the Interests of Shareholders.	15
	(a) Role of the Courts and Legal Draftsman	15
	(i) Powers	15
	(ii) The Object Clause.	17
E.	REFORM OF THE ULTRA VIRES DOCTRINE. . . .	23
	(1) Preliminary Points.	23
	(a) Constitutional limitations. . . .	23
	(b) Functional limitations.	23
	(c) Extra-provincial companies. . . .	25

PAGE NO.

(2) General Approaches to Reform. 26
(3) Constructive Notice 27
(4) Indoor Management 27

F. APPROACHES TO REFORM OF THE ULTRA VIRES DOCTRINE I: THE RETENTIONISTS. 28

(1) Introduction. 28
(2) General Advantages and Disadvantages. 28
(3) Discussion of Individual Approaches . 31

(a) The Cohen Report. 31
(b) The Jenkins Report. 32
(c) European Communities Act. 33
(d) The U.S. Reform 36
(e) Australia 42
(f) Israel. 43
(g) The Lawrence Report (Ontario) . . 44
(h) The Ontario Business Corporation Act 45
(i) Draft Ghana Code. 48

G. APPROACHES TO REFORM OF THE ULTRA VIRES DOCTRINE II: THE ABOLITIONISTS 54

(1) Introduction. 54
(2) General Advantages and Disadvantages. 54
(3) Discussion of Individual Approaches . 56

(a) The Dickerson REport. 56
(b) The Canadian Business Corporations Act 60
(c) The British Columbia Companies Act 62
(d) New Brunswick 65

H. RECOMMENDATIONS AND CONCLUSIONS 67

I. FOOTNOTES

J. BIBLIOGRAPHY

A. INTRODUCTION

There is general consensus among businessmen, company law reformers and legislative draftsmen, that the doctrine of ultra vires, as it pertains to corporations, has, as Gower puts it, "outlived its usefulness".[1] The purpose of this paper is to examine the various responses to the problems caused by the dictrine, as formulated by other jurisdictions and various Law Reform Committees, so as to attempt to develop the most effective approach for a possible reform in the Alberta law, in this area.

In order to better understand the various approaches to the ultra vires doctrine, this paper will first briefly discuss the rule itself, its history, and its use in Alberta. Then we will discuss the various interests it was designed to protect and the modern day practices which are dissipating that protection and examine in detail the various Canadian, British, American and other responses for reform to the doctrine. Some personal comments and recommendations will conclude the discussion.

B. HISTORY OF THE ULTRA VIRES DOCTRINE

(1) Definitions

It is first necessary to distinguish the use of the term "ultra vires" in its proper use, from other acts to which the term has been used. A most useful series of definitions is found in Corpus Juris Secundum, Vol. 19, pp. 419-421:

> The primary sense and the proper use of the term "ultra vires," in so far as it applies to corporate transactions, is to describe corporate transactions which are outside the objects for which the corporation was created, as defined in the law of its organization, and therefore beyond the powers conferred on it by the legislature;[31] ~~and it is in this~~

> *Ultra vires and illegality distinguished.* Although, ~~as appears above~~, the phrase "ultra vires" has been used to designate, not only transactions beyond the express and implied powers of the corporation, but also transactions which are contrary to public policy or contrary to some statute expressly prohibiting them, the terms "ultra vires" and "illegality" represent ideas which are totally distinct and altogether different.[40] A corporate transaction may be illegal in the true and proper sense, or it may be ultra vires without being illegal.[41] According to the weight of authority, when corporate acts are spoken of as ultra vires, it is not intended that they are illegal, but merely that they are not within the powers conferred on the corporation by the act of its creation.[42]
>
> *Acts ultra vires the corporation and ultra vires the officer or agent distinguished.* Another sound distinction exists between acts which are wholly outside the power of the corporation and acts which, while within the power of the corporation, are not within the scope of the powers or duties of the particular agent or officer of the corporation who attempts to perform them; the latter class of acts although they may be ultra vires the corporation are not necessarily so.[43]

> ***Transactions executed in unauthorized manner.*** As appears above, the term ultra vires has, in some instances, been used to designate corporate transactions which, although within the powers granted, are performed in a manner different than that prescribed by the charter or by general law, but this is a misuse of the term.[44] There is a distinction between the doing by a corporation of an act beyond the scope of the powers granted to it by law and an irregularity in the exercise of a granted power; in the latter case the power exists to do the act, provided it is done in the prescribed way.[45]

> ***Ultra vires and excess or abuse of power distinguished.*** Although the term "ultra vires" has been used to apply to a corporate transaction which while within one of the powers of the corporation is in excess or abuse of such power, such use is secondary, for such act is within the power of the corporation although the purpose for, or extent to, which the power has been exercised may not have been contemplated by the law creating the corporation.[46] An abuse of power conferred, in failing to comply with a prescribed preliminary requirement, does not render a corporate contract ultra vires.[47]
>
> ***An intra vires act*** is defined as one within the scope either of the corporation's express or implied authority.[48]

(2) Origin

The doctrine of ultra vires originated in the early 19th century and was basically the invention of the English judiciary who used it to protect possible investors in the company and creditors of the company.

Briefly stated, the ultra vires rule states that:

A company which owes its incorporation to statutory authority does not effectively have the capacity to do anything beyond the powers expressly or impliedly conferred upon it by its statute or memo of association. Any purported

activity outside that capacity will be ineffective even if agreed to by all the members.

The decision of the House of Lords in Ashbury Railway and Iron Co. v. Riche (1675) L.R. 7 H.L. 653, conclusively established the doctrine of ultra vires in memo of association jurisdictions by striking down a contract entered into by a company, pursuant to an activity not sanctioned by the company's memo of association--even though it was later ratified by all the members--the court holding that ratification was legally impossible because the contract was beyond the scope of the memo and therefore void:

> The court held that the company's objects state: "affirmatively the ambit and extent of vitality and power which by law are given to the corporation and it states if it is necessary to so state, negatively, that nothing shall be done beyond that ambit and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified."[2]

(3) Current Alberta Practice

At present, because under our Companies Act, companies are incorporated by statutory authority, the doctrine of ultra vires is in full force in Alberta, and the extensive case law, as developed from The Ashbury Railway and other cases remains in effect.

Under s. 16(b) the memo of association of a limited company must state the 'objects of the company' (see s. 17(b) for Guarantee Companies and 19(b) for special limited companies), and these objects must be filed with the Registrar. The effect of registration is to bind the company and its members to observe all the provisions of the memo and articles subject to provisions of the Act.

Ancillary to the stated objects clause of each company, s. 20(1) of the Act deems every company to have numerous express 'powers' for the purpose of carrying out its objects (Note: the important but often confusing distinction between a company's powers and objects will be discussed in the next section). A company can add or exclude any power by means of an ordinary resolution under s. 34(2). In addition to s. 20, the Act grants a number of other specific powers.[3]

The alteration of a company's objects clause is possible in Alberta under s. 34(1) of the Act. However, the alteration process is much more complex than is the one for alteration of powers in that under s. 34(1) a special resolution (3/4 majority) is required and it must be confirmed by an order of the court. The court is required to have regard to the rights and interests of the members of the company as well as to the rights and interests of third parties.

(4) Extra-Provincial Capacity

By s. 8(2) of the Companies Act, the province has legislative power to authorize a company to accept powers and rights outside the province. The situation at present is that any Alberta company which carries on business in an extra-provincial jurisdiction, is still bound by the doctrine of ultra vires. Similarly, an extra-provincial from a jurisdiction where ultra vires is abolished or does not apply (B.C.), will not be subject to the ultra vires doctrine if it carries on business in Alberta.

C. THE RATIONALE OF THE ULTRA VIRES DOCTRINE

(1) Unacceptable Rationales

A number of grounds have been offered in support of this doctrine, only two of which seem to be of genuine importance. The list includes:[4]

(a) Want of corporate power to make the contract.
(b) Illegality.
(c) Notice of the limitations on corporate power.
(d) Public policy.

None of the above four grounds furnishes any concrete support for the doctrine.

(a) This rational is a logical deduction from the fiction theory of corporate existence. It is reasoned that the corporation has only such powers as are given it by its creator and thus has no capacity to exceed these powers. This kind of argument has no merit in an era where corporations are not created by special Acts--where persons are free to decide for themselves what the nature of their corporation shall be and what powers it shall have. As well the use of the word 'power' is a misnomer since the law is concerned with 'authority', not 'power'.

(b) As already indicated, an ultra vires act as such is not an illegal act. A more specific prohibition must exist in the law for the act to take on the flavor of illegality.

(c) This rationale is based on the constructive notice doctrine whereby everyone is deemed to have knowledge of the contents of all publically filed documents, i.e., the objects.

The use of this concept has been found particularly objectionable as being unrealistic and contrary to actual business practices. Also, even if persons actually did acquire such knowledge, they would be subject to their peril in deciding whether any given action does or does not come within the enumerated purposes or powers of the corporation.

(d) It can be argued that the state, representing the interests of the general public and the welfare of society, has an interest in corporations keeping within the bounds of business which they have been organized to pursue. On the other hand, is the public interest being served by allowing companies to escape contracts with third parties using this doctrine? Obviously protection of the public is one of the major rationales behind the whole scheme of corporation law, but for our purposes in studying this area, its importance is not large.

(2) The Accepted Rationales

In two areas however--protection of shareholders and protection of third parties dealing with the company--the original doctrine of ultra vires did have firm rationales.

Shareholders

It has generally been accepted, that one of the main rationales behind the doctrine of ultra vires is protection of the shareholder. The doctrine was instituted in order that the shareholder should be protected in the ways he invests his money,[5] as well as being protected for the continued security of the investment or the investor's vulnerability to involuntary alteration.

Third Parties--Persons Dealing with the Company

The second accepted rationale for the ultra vires doctrine is one which is at odds with the above mentioned rationale and as we shall see, the balancing of the interests between these two interest groups poses the major problem with regard to reform in this area.

Third parties dealing with the company are theoretically protected by the ultra vires doctrine in that when they allow credit to a limited company they will derive some assurance that the company's assets will not be dissipated in unauthorized enterprises.

Persons dealing with the company fall into these categories: debtors, intra vires creditors and ultra vires creditors, and we will deal with each in detail in the next section.

D. HOW EFFECTIVE IS THE ULTRA VIRES DOCTRINE?

(1) Introduction

The major premise of this paper is that the doctrine of ultra vires no longer serves the purposes for which it was originally designed to do. Indeed, to a modern day corporation, its shareholders and to the parties dealing with it, it is a hindrance and at times an insurmountable obstacle.

In order to better examine the modes of reform in this area, it is first necessary to examine in some detail just how effective the doctrine is today in protecting the interests of both shareholders and third parties.

(2) Protecting the Interests of Third Parties

As we have seen, one of the original rationales for this doctrine was to provide a mechanism for outsiders dealing with the company who wanted assurance that the company's assets would not be dissipated in some unauthorized activity.

Today however, outsiders have not been able to rely on this doctrine for protection and it has been generally accepted by all reformers, that as towards third parties, the doctrine should be abolished.

As noted earlier, third parties dealing with a company fall basically into three categories and we will now examine each one individually:

(a) Debtors

The typical situation in this area is one where a debtor is seeking to avoid performance of a contract with a third party by asserting that the third party's act in executing the contract was outside its scope and therefore, ultra vires the third party

The courts have not given effect to this argument--especially where the debtor has received substantial benefits under the contract. In the leading Canadian case, Breckenridge Speedway Ltd., Green et al v. R. (1967) 61 W.W.R. 257 (Alta. A.D.), the plaintiff company argued that an agreement to lend it money by the defendant Treasury Branch should be rescinded because the Act of the Treasury Branch was authorized by a provincial Act (The Treasury Branches Act, 1955) which the plaintiff argued was ultra vires the capacity of a provincial legislature to pass.

It was held by the court that (per Smith C.J.A.):

> The authorities to which I have referred appear to me to justify the conclusion that it would be 'inequitable and unjust' for a borrower from a corporate to be permitted to allege that the lending was ultra vires on the part of the lender and that he would be precluded from doing so, or that such a plea does not lie in his mouth.[6]

See also the Australian decision In Re K. L. Tractors Ltd. [1961-62] 106 C.L.R. 318 for a similar decision.

These decisions clearly seem proper. A debtor should not be able to invert the doctrine in this way to allow himself a windfall at the expense of a company.

(b) Creditors

(i) Intra vires creditor

An intra vires creditor is one who has extended credit to a company in terms of a transaction which was intra vires the company. The typical situation facing the intra vires creditor is whether he can extend some kind of control over the use of the money or asset he has lent to the company so that if the company undertakes an ultra vires act, the creditor can restrain the company.

The arguments put forward by an intra vires creditor is that there is an 'implied term' in his agreement with the company that the company will not dissipate the funds in an unauthorized manner, based on a 'trust fund theory of cpaital', that the money is held in trust by the company for the creditor.

This argument has not been accepted by the courts. In Page v. Austen (1884) 10 S.C.R. 132, Strong J. held:

> The property of a corporation is not regarded as a trust fund for the payment of its general creditors--nor have creditors any other, or greater rights in respect of such property than every creditor has against the property of an individual debtor.

As Wegenast put it "so long as the company is solvent, it is not the concern of the creditors to censor its transactions."[7]

As well as Getz points out in his article Ultra Vires and Some Related Problems,[8] there is another possible way in which intra vires creditors are not protected. Even if,

on the basis of a director's opinion clause such as in the Bell Houses case,[9] a creditor could argue that the actions of the company were not ultra vires the company but merely outside the scope of the director's authority, the intra vires creditor is not protected because it has been held in cases such as Attorney General of Canada v. Standard Trust[10] that the fiduciary duties of dirdctors are not owed to, and are unenforceable by creditors.

(ii) Ultra vires creditors

An ultra vires creditoris one who supplies goods, property or services to a company under a contract, transaction or agreement for sale which is clearly beyond the capacity of the company and ultra vires. At issue is whether the creditor can enforce the agreement and claim the price.

It is in this area where most of the injustice is done to creditors and where the greatest harm results from the use of the doctrine. In dealing with this problem, the courts have often confused the notion of corporate capacity with constructive notice so that creditors can never enforce an ultra vires contract with a company.

The approach of the courts in this area has been twofold:

Capacity

The courts will hold that the contract is invalid based strictly on the fact of noncapacity. As Getz argues "the point is simply that the doctrine of constructive notice is irrelevant to the ultra vires doctrine."[11]

An illustration of this approach in Canada is found in the decision of Machray's Department Store Ltd. v. Zionist Labor Organization (1966) 53 D.L.R. (2d) 657 (Man. Q.B.). The court allowed the company, as purchaser under an agreement for sale to escape from the contract because the defendant company (being a society under the Manitoba Corporations Act) did not have the corporate capacity to purchase land.

Capacity and Constructive Notice Intermingled

There is a line of established law which attempts to introduce the doctrine of constructive notice into the ultra vires situation. Although as Getz points out above, the constructive notice doctrine is irrelevant in this context, it is the basis behind many decision in which creditors have been unjustly treated. In response to this problem, most reformers advocate abolition of the constructive notice doctrine as it relates to ultra vires.

An illustration of the harm which can result to a creditor is found in the Jon Beauforte case.[12] The company was authorized to carry on business as gown makers but decided to undertake the business of making veneered panels which was admittedly ultra vires. A firm, with no actual knowledge that the veneer business was ultra vires, supplied coke to a factory built by the company to manufacture the panelling. The court held that the coke suppliers "as they had constructive notice of the contents of the memorandum of association had notice that the transaction was ultra vires the company."[13] And the contract was declared void.

There is no doubt that the use of ultra vires in this context does not protect the creditor, it only prejudices him,

by deeming the third party with knowledge of a company's objects so that he will always be deemed to know when a transaction is ultra vires.[14]

(c) Other Cases

(i) Tort and Crime

The area of tort and crime as related to the ultra vires doctrine is uncertain. The accepted view is that the doctrine does not apply to tortious or criminal liability, so that if a dealing with a third party is ultra vires the third party cannot, as an alternative means of getting compensation, sue the company in tort ordering a criminal action. Thus, the ultra vires doctrine cannot be circumvented in this way.

(ii) Remedies

Despite the stamina of the doctrine of ultra vires in terms of survival in modern day jurisdictions, courts have been reluctant to allow windfalls to companies at the expense of third parties and have developed a complex series of remedies which an ultra vires creditor might use for protection.[15]

For the purposes of this paper, it is necessary only to footnote the kinds of remedies available.[16] It is sufficient for our purposes to note, that the use of these remedies are limited and that their application by the courts is often technical and complex (see for example, Sinclair v. Brougham [1914] A.C. 398). The protection of creditors in this way is inconsistent, uncertain and in no way alleviates a third party from the strenuous rigors of the ultra vires doctrine.

(3) Protecting the Interests of Shareholders

The second major interest group which the doctrine of ultra vires was originally designed to protect was the potential investor. As noted earlier it is generally accepted by most reformers that ultra vires should be abolished as towards third parties but a major problem arises in balancing the interests between shareholder and third party protection. Many reformers advocate that the best way to maintain this balancing of interests in equilibrium is to retain the doctrine of ultra vires as between shareholders and the company. It is therefore necessary to examine in detail the scope of the protection offered at present, by the doctrine to shareholders.

(a) Role of the Courts and Legal Draftsman

Both the courts and, to a much larger extent, the legal draftsmen have utilized numerous devices which have limited the protection of the shareholder.

(i) Powers

The delineation between objects and powers is an important one but it is one that is often confused. Powers are only useful in effectively carrying out the objects of a company and are merely incidental to the objects. Without objects in a company powers are ineffective.

However, by broadening the powers in a company, or by registering memos with numerous object clauses confusing power with purpose and indicating every class of act which the company is to have power to do--a skilled draftsman can effectively delimit the importance of the ultra vires effect.

Implied Powers

As early as 1880, the House of Lords held in A.-G. v. Great Eastern Railway Co. (1880) 5 App. Cas. 473 that the doctrine of ultra vires was to be applied 'reasonably' and that the court would imply powers to a company to the extent of "whatever may fairly be regarded as incidental to or consequential upon the specified objects. . . ."[17]

Wide Power Clauses

Not content to rely on the court being able to imply the necessary powers to a company, draftsmen began to draft wide object and power clauses intermingling the two in an attempt to cover all the possible powers a company could have.

The courts attempted to curtail this activity by using the 'ejusdem generis' rule of construction (German Date Coffee Co. (1882) 20 Ch. D. 169,188 (C.A.)) but the draftsman retaliated by making use of the 'independency' clause, and the 'director's opinion clause', both of which have been upheld by the courts.[18]

Deemed Power Clauses

Adding further confusion to the objects/powers delineation, most memo of association jurisdictions, including Alberta have deemed to every company the widest powers possible in order to carry out any of the objects of the company. Not only is this kind of list(as appears in s. 20(1) of the Alberta Act) cumbersome, but it can lead to confusion to possible investors.

(ii) The Object Clause

As noted earlier in Alberta a company must file with the Registrar a copy of the proposed objects of the company. A potential shareholder then has access to those filed documents so that he can determine whether the company is about to carry on business in a field of activity which is favourable to the shareholder. This, theoretically, is the way it should work so that a shareholder's interest can be protected through the use of ultra vires. However, the draftsman and the court have in effect circumvented any protection which the doctrine has given by means of some effective tampering with the object clauses.

The current practice of filing long, complex object clauses

Notwithstanding the fact that the Legislature intended that a company's objects be set out succinctly in only one or two paragraphs, businessmen are not content to specify only the business which the company initially intends to follow, but prefer also to name all the other businesses which they might conceivably want to turn to in the future.

Thus the draftsman fills up paragraph after paragraph of objects, covering every conceivable business, and as Gower points out, "it affords little assurance of the presentation of the company's assets and less control over the activities of directors."[19]

'Independency' Clauses

In order to prevent company's from filing vast lists of objects, the court began applying the 'ejusdem generis' rule of construction saying that the main objects specified

in the first few paragraphs were the main objects, and the latter paragraphs should be read as powers pertaining only to their achieving the purposes of the main objects (In Re German Date Coffee Co. at p. 169, 188).

The draftsman was able to circumvent this problem by inserting an 'independency' clause in their objects to the effect that "the objects specified shall be regarded as independent objects and not be limited or restricted by reference to or inference from terms of any other paragraph."[20] The courts have upheld this clause (Re Anglo-Cuban Oil Co. Ltd. [1917] 1 Ch. 477 (C.A.)).

Director's Opinion Clauses

The most effective achievement of the legal draftsman (in terms of effectively destroying the use of ultra vires as a protection for shareholders) is in the use of a director's opinion clauses (consult footnote #9 for an example of a typical type of director's opinion clause).

Clauses of this type have been upheld as valid in both the U.K. (Bell Houses Ltd. v. City Wall Properties [1966] 2 All E.R. 674 (C.A.)) and Canada (H. & H. Logging Co. Ltd. v. Random Services Corporation Ltd.(1967) 63 D.L.R. (2d) 6 (B.C.C.A.)). It was held in Bell Houses that:

> As a matter of pure construction, the meaning of these words seems to me to be obvious. An object of the plaintiff company is to carry on any business which the directors genuinely believe can be carried on advantageously in connexion with or as ancillary to the general business of the company. It may be that the directors take the wrong view and in fact the business in question cannot be carried on as the directors believe; but it matters not how mistaken the directors may be. Providing they form their view honestly, the business is within the plaintiff company's objects and powers. This is so plainly the natural and ordinary meaning of the language of sub-cl. (c) that I would refuse to construe it differently unless compelled to do so by the clearest authority; and there is no such authority. Indeed the authorities establish that the obvious meaning to which I have referred is in law the true meaning of the words.

Let us now examine the implications of the kind of clause as it pertains to shareholder's protection and ultra vires. It should first be noted that the Random House decision went much further than Bell Houses in that the court upheld the carrying on of a business by the company in a completely unconnected field of activity to that which was previously undertaken by the company. In Bell Houses, the court emphasized that the new activity arose "in connection with and as ancillary to the general business of the company."[21]

Loss of Shareholder Protection

The most important implication of the Bell Houses clause is that, obviously, any protection which the objects clause might previously have given to shareholders has vanished, in that the directors, as long as they act bona fide, can venture into new businesses, cease activities in old ones or generally change the whole substratum of enterprise that the corporation is based on, and the individual investor can in effect, do nothing about it. His remedies at common law are highly restricted. Even the shareholder's ultimate weapon--the power to petition for the winding up of a company when its whole substratum had disappeared (Re German Date Coffee Co. (1882) 20 Ch. D. 169 (C.A.)) will be lost. In effect, the directors will be free to pursue all bona fide activities without the worry that the shareholders are lurking in the background and could potentially wind up the company.

Rise of Management Power

Concernment with this sharp decline in the protection of the shareholder, the use of a Bell Houses clause and the 'independence' clause indciate a rise in control and power of management in a company. Any protection which the ultra vires doctrine could give to a shareholder has been lost due to the work of the draftsman.

It should be noted that some writers have argued that the ultra vires doctrine is more of a nuisance to companies then it is a protection for shareholders in that the object clauses are not what the investor makes his decision to invest on. With regards to the argument that management power is rising, they argue that this increase is more apparent than real. Thompson in The Ultra Vires Doctrine and the Jenkins Report[22] argues that this management power would be subject to practical limitations. If a company was engaged in a profitable activity, it is unlikely that it would change. Even if such a change would take place, Thompson argues that a shareholder might have an action for breach of a director's duties. In response to this kind of argument, Getz maintains that a company's "continued profitability may be threatened by losses sustained in additional activities which are more speculative in character, and which, under a Bell Houses type of clause, could be embarked upon without consultation of the shareholder."[23]

The original doctrine as emphasized in Ashbury Railway clearly stated that even a unanimous ratification by the shareholders could not give a company the necessary capacity to perform an ultra vires act. The Bell Houses clause has taken this power and "what the members formerly could not do by unanimous agreement, the directors now can do by simply majority at a board meeting. The hand of corporate management has been thereby immeasurably strengthened."[24]

Contractual rights between the shareholder and the company

Section 29 of the Companies Act binds the shareholder and the company contractually to observe the provisions of the memorandum and the articles. Because of this contractual

right, a shareholder has capacity to bring an action to have the company observe the provisions of its contract with him, i.e., confine the activities to the stated objects. But the Bell Houses clause alters this contractual right so that a shareholder can now only bring an action if he can prove a lack of bona fides on the part of the directors in not acting in the best interests of the company. As Dankwerts L.J. stated in the Bell Houses case:

> . . . the shareholders subscribe their money on the basis of the memorandum of association and if that confers power on directors to decide whether in their opinion it is proper to undertake particular business in the circumstances specified, why should not their decision be binding? The shareholders by taking shares on the terms of the memorandum agreed to it.[25]

Duties of directors and capacity of company

Getz raises another issue[26] in which a Bell Houses clause could have a significant effect. If a shareholder does seek to impeach some action on behalf of the company sustainable only due to a Bell Houses clause, the question arises as to whether the action is directed towards the capacity of the company or to the duties of the directors. The proper characterization of this problem is essential because if a company can successfully argue that the act in question merely affected the duties or powers of directors, then it is possible that the alleged breach of duty is one which the majority may approve. Thus, due to the common rule in Foss v. Harbattle rule, no action will be at the instance of the minority. Moreover, even if a minority action is appropriate, no relief will be available against third parties under the doctrine because the problem is no longer one of corporate capacity, but of director's duties. In order to succeed, mala fides on behalf of the directors would have to be proven.

Alteration of objects clauses

We noted earlier the mechanism by which an Alberta company can change its object clause. For our purposes, the important point to note is the liberal interpretation given by the courts to a s. 34(1) alteration:

> The court should not be astute to fetter commercial enterprises by a narrow construction of the remedial clause. In fact, surely, jurisdiction is of the widest scope and particular decisions should depend on discretion, and alterations be refused where it appears that creditors, shareholders or others having a special interest are being prejudiced.[27]

However, it should be noted that a court will not allow alterations for any other purpose than one set out in s. 34(1).

Conclusion

It seems apparent that the various judicial, legislative and corporate "attacks" on the objects clause leads to the conclusion that protection of the shareholder is now merely a theoretical ideal. In practice, neither the registration of a company's objects clause or the doctrine of ultra vires which was created to protect those who relied on the objects clause, are of any beneficial effect to a modern day corporate system.

E. REFORM OF THE ULTRA VIRES DOCTRINE

This section will examine in detail the various reform approaches to the doctrine of ultra vires.

(1) Preliminary Points:

(a) Constitutional limitations

It must be noted initially that the provincial Legislature is itself restrained in its ability to confer powers and capacity on corporations due to constitutional limitations. The provincial Legislature itself has authority only in certain areas (as per the B.N.A. Act) and cannot therefore allow the incorporation of a company provincially to carry on a business outside the scope of that provincial authority.

Thus if a company was to be given the capacity of a natural person, that capacity is actually limited by the above noted constitutional limitations.

(b) Functional limitations

In Alberta there are numerous types of specialized companies which are governed by their own Acts and would not be governed by the Companies Act. Currently, section 13 deals with the problem in terms of 'powers' of a company. If, as will be recommended later in this paper, that a company be given the power of a natural person, a change in the approval of this section might be required.

Other provinces in Canada which have either abolished or modified the Ultra Vires doctrine have dealt with this problem in two ways:

Ontario [28]

[Subsec. (9) substituted by 1972, c. 138, s. 1(5).]

2. (1) Application.—This Act, except where it is otherwise expressly provided, applies, .. ~ '

but this Act does not apply to a corporation incorporated for the construction and working of a railway, an incline railway or a street railway, or to a corporation within the meaning of *The Loan and Trust Corporations Act* except as provided by that Act.

(2) Idem.—This Act does not apply to a corporation that,

(a) is a company within the meaning of *The Corporations Act* and has objects in whole or in part of a social nature;

(b) is a corporation or company within the meaning of Part V of *The Corporations Act;*

(c) is a corporation that is an insurer within the meaning of subsection (1) of section 161 of *The Corporations Act;*

(d) is a corporation to which *The Credit Unions Act* applies, 1970, c. 25, s. 2.

B.C. [29]

23. (1) Subject to subsection (2), a company has the power and capacity of a natural person of full capacity.

(2) No company has the capacity

(*a*) to operate a railway as a common carrier; or

(*b*) to carry on the business of insurance, except as authorized by clause (*d*) of subsection (1) of section 35; or

(*c*) to operate as a club, unless authorized in writing by the Attorney-General; or

(*d*) to carry on a business that is trust business as defined in Schedule A of the *Trust Companies Act.* 1973, c. 18, s. 23.

It is submitted that the Ontario approach is more preferable to either the new B.C. legislation or the current Alberta section. Because the B.C. Act deals with 'capacity', the Ultra Vires problem, with its complexities and potential injustices continues to survive to a limited extent.

The Alberta section deals with 'powers' of a

company, and again, if companies are given full powers of a natural person, then this kind of section will be redundant.

The Ontario section speaks in terms of applicability of the Act itself, and this method seems preferable in that a company cannot, for example, sell insurance, because the Ontario Business Corporation Act does not allow it to, not because it is restricted from doing so in terms of capacity and power. Slutsky, in his article Ultra Vires - The British Columbia Solution suggests that one possible solution is:

> . . . to state in the statute that any company of full capacity which engages in any of the prohibited businesses or activities would be liable to have its certificate of incorporation cancelled and be struck off the register, with the added provision that the dissolution should be without prejudice to rights acquired by parties prior to the date on which the company is dissolved.[30]

(c) Companies operating extra-provincially

One of the more important considerations in dealing with reform of provincial laws is consistency of approaches among the provinces. This becomes apparent in areas such as ultra vires. For example, under s. 8, an Alberta incorporated company has capacity to accept powers to effect its objects or purposes outside the province. If it carries on business in British Columbia, it is still subject to Alberta law (which includes the Ultra Vires doctrine) although a British Columbia incorporated company carrying on business in B.C. is subject to B.C. law (which does not include the Ultra-Vires doctrine). Thus consistency in the various provincial laws is a desirable goal; and the recommendations for reform at the end of this paper will reflect that goal. Unfortunately,

the two provinces whivh have reformed their Company Laws Act to date, B.C. and Ontario, have adopted significantly different approaches to the Ultra Vires problem.

(2) General Approaches to Reform

Introduction

As we noted earlier, the major conflict which the Ultra Vires doctrine attempted to balance is the need to protect the interests of the investors and shareholders in a company while at the same time, protect the rights of third parties dealing with the company. It has generally been accepted among most reformers to this common law doctrine, that as between the corporation and third parties, the doctrineshould be abolished. There are however, numerous variations on this theme, which we shall discuss in this section.

The main problem is how to best protect the shareholder of a company, and it is in this area where the approaches differ and where significant changes in the law can be made. The approaches fall generally into two categories:

i) abolitionist
ii) retentionist

Generally, the abolitionist approach, as exemplied by the Dickerson report, advocates abolishing the doctrine for all purposes. The retentionists, as exemplified by the Draft Ghana Code and the Ontario Business Corporation Act, favour retaining the doctrine as between shareholders and

the company. We shall discuss each approach (and the variations of each approach in detail) following a brief discussion of the role played by the doctrine of constructive notice and the indoor management rule in this context.

(3) Constructive Notice

It was noted earlier that as long as the doctrine of constructive notice is in effect, no third party will ever be deemed not to have knowledge of a company's capacity. Even if a company is given the capacity of a natural person, it is still left open for the company to place restrictions on themselves, file this in their articles, and again, a third party is deemed to have notice of them. As well, we noted earlier that the use of the doctrine, in relation to the Ultra Vires doctrine is probably an unfortunate misconception because Ultra Vires is concerned merely with capacity, and has no knowledge requirements. Thus it is submitted that to make any effective changes in the area of corporate capacity and its effect on third parties, the doctrine of constructive notice, as it applies to Ultra Vires will have to be reformed.[31]

(4) Indoor Management

The rule in Royal British Bank v. Turquand states that a person dealing with a corporation is entitled to assume that its internal procedures have been properly complied with so that the third party is not under any obligation to inquire as to whether there has been this compliance. This is a safeguard for third parties and the trend in Canada jurisdictions is to embody this rule in their Companies Act, and might also be considered in conjunction with the alteration of the rights of third parties and companies, that we are discussing in this section.

F. APPROACHES TO REFORM OF THE ULTRA VIRES DOCTRINE I: THE RETENTIONISTS

(1) Introduction

The retentionist approach to the problems created by Ultra Vires is an older, less radical and much more incomplete solution than the abolitionist approach. Its major feature is that the doctrine is abolished or severely limited as between third parties and the company, but maintained as between the company and its members (shareholders).

(2) General advantages and disadvantages

The major advantage to this approach is that it all but clears up the most obvious of the problems created by the doctrine. In effect, most retentionists give the corporation - as between itself and third parties - the capacity of a natural person. This removes all problems of capacity, is a strongboost to the legal rights of third parties who find themselves involved in a question regarding a companies capacity (as in a Jon Beauforte type situation) and removes the complexities facing a creditor in trying to find a legal remedy. The question of corporate capacity is intricately mixed with the constructive notice doctrine, and as noted earlier, most retentionists have also modified the constructive notice rule in line with this approach.

A third party, under the retentionist approach, is able to rely purely on contractual law and the principles of Agency in order to enforce his rights (and some retentionists have created stautory remedies for their parties as well).

Although this approach does clear up one area of the problem, there are numerous other areas where the approach either does not go far enough, or indeed, creates its own problems. Each jurisdiction or reform committee's approach varies but there are some general problem areas which can be noted at this point, before each form of retentionist approach is examined separately.

The major disadvantage to the retentionist approach is that it retains the Ultra Vires doctrine complete with object clauses and all the assorted problem as between the company and its shareholders. Thus all the numberous problems and defects noted in the earlier discussion on shareholder protection will continue to flourish under the retentionist approach thus making this kind of approach, in the view of the author, an undesirable one. With the exception of Gower's Draft Ghana Code, this approach offers no remedy for the use of devices such as the long, wide object clause, Bell Houses clause, or an independent clause. In effect, the retentionists perform a severe disservice to the shareholder or potential investor by advocating the retention of a doctrine which is utterly useless in terms of protection but prohibits the introduction of a system of safeguards which would achieve the desired effect.[32]

Getz criticizes the retentionist approach on two counts:

> . . . first, they tend to emphasize the protection of outsiders dealing with companies; second, they seem to have viewed the Ultra Vires problem in isolation, divorced from the fabric of company law as a whole.[33]

His first point has been discussed in the above paragraphs. As to his second point, it is also well founded in that it can be seen that by merely abolishing the Ultra Vires problem between third parties and the company, no defects are cured, and indeed, new ones are created. As noted earlier the law regarding constructive notice must be modified. Also, the confusing dichotomy between power/capacity must be cleared up so both shareholders and third parties are aware of the important differences between the two.

Another major problem which the retentionist approach does not affect is the introduction of mechanism to deal with the shift in the control of the company into the hands of management. With unlimited capacity to do anything as towards a third party, the management has removed a substantial amount of control from the shareholders, who are forced to sit idley by with their limited common law rights to prevent the company from entering into a contract which either threatens the security of a shareholder's investment, or is the type of contract which a shareholder does not approve of or would not have invested in the company had he known that the company would have moved in that area. As well, third parties under this approach, are still bound by the principles of agency and must fall within those rules to seek relief as there is, on the whole, no statutory relief for creditors.

As has been often noted in this paper, the rationale behind the Ultra Vires doctrine is reasonable and salutory. However neither the present common law doctrine nor the majority of the retentionists achieve the dual purpose of shareholder and third party protection. Only Professor Gower, in his suggestions for the Ghana Company Code has devised a

retentionist approach which provides the two-fold protection, although its workability may be suspect. His system, along with the other retentionist approaches will be dealt with individually, in the next section.

(3) Individual Retentionist Approaches

(a) Report of the Committee on Company Law Amendment (cmd. 6659 1948, para. 12 - The Cohen Report [34]

The Cohen Committee was the first Commonwealth attempt at reform of company law. With regards to ultra vires the Committee recommended that companies, as regards third parties should have the same powers as an individual. They recommended the retention of the doctrine as between the company and its shareholders and an easier method of alteration of the objects clause by not requiring a court order but merely a special resolution to change them.

The only actual change which resulted from this report was an amendment to the U.K. Companies Act in 1948 which allowed alteration of a company's articles in certain specified areas merely by special resolution.

Discussion

This Cohen report is an example of the way the ultra vires problem has been treated in isolation. The Committee did not make any recommendations regarding changes in the constructive notice doctrine so that a third party would still be deemed to have knowledge if any director or other officer exceeded his authority.

Note also that the Cohen recommendations refer to 'powers' and not ' capacity' so that on a literal interpretation, the corporation would still be limited by its objects in terms of capacity, although it would have all powers of a natural person with which to achieve those objects. Thus, even third parties are still vulnerable to some extent at least to corporate incapacity and ultra vires

(b) Report of the Company Law Committee Cmnd. 1749, June '62, Jenkins Report[35]

The Jenkins report was a 1962 survey of British corporation law and its possible reform. For the reasons outlined in the report (which included a large fear of placing too much power in director's hands), the Committee recommended the retention of ultra vires. However they also recommended numerous charges which they hoped would eliminate ultra vires problems between the company and third parties. They recommended that no contract made in good faith should be held invalid on the ground that it was beyond the powers of the company and that the third party would not automatically be deemed to have constructive notice. Even actual notice was not a bar if the third party acted reasonably. In order to enforce the contract however, the third party must be willing to fulfil his part of the bargain.

Discussion

The major thrust of the Jenkins Report is that by giving the company the powers of a natural person, the law is placing too much power in the hands of the directors who, because the company is itself not a natural person, and must exercise its authority through directors, would get wide powers exercisable in their entirety by management. The Committee thought this such an important threat that

they recommended retention of the doctrine, on one hand and made a half-hearted attempt on the other to cure the most obvious problem--that of the third party. Thus again in this report, we find an approach which did not consider everyone to whom the doctrine was designed to protect.

In an article entitled The Ultra Vires Doctrine and the Jenkins Report, J. H. Thompson argued:

> The Jenkins Committee would thus seem to be paying lip service to a discredited and ineffective attempt by legislators and judiciary to give a theoretical protection to investors and creditors which is neither wanted nor needed: unwanted because the restriction on a company's activities may ultimately operate against the shareholders' interests in preventing development in new and profitable directions; unneeded, because which persons can obtain little assistance from objects clauses in their present form and can attach little significance to them as compared with other available sources of information about the company.[36]

The Jenkins Report, along with the Cohen Report is useful in that it recognized some of the more important considerations which reformers in this area must grapple with. However, the responses of both do little in solving the many problems associated with ultra vires.

(c) Section 9 of the European Communities Act 1972

This British Act came into force on January 1, 1973, and was enacted in order that the law of Britain comply with the requirements of membership in the European Economic Community.

The notes to s. 9(1) indicate that the object of this particular section

> . . . is to afford protection to a person dealing with the company in good faith. The ultra vires doctrine is restricted but not abolished by subsection (1). This doctrine can no longer be relied upon by the company against a third party who has acted in good faith. On the other hand, internally, the operation of the Ultra Vires doctrine is not affected by subsection (1). . . . Further, a third party can still calim as against the company that the latter has acted ultra vires.

> **9.**—(1) In favour of a person dealing with a company in good faith, any transaction decided on by the directors shall be deemed to be one which it is within the capacity of the company to enter into, and the power of the directors to bind the company shall be deemed to be free of any limitation under the memorandum or articles of association; and a party to a transaction so decided on shall not be bound to enquire as to the capacity of the company to enter into it or as to any such limitation on the powers of the directors, and shall be presumed to have acted in good faith unless the contrary is proved.

Discussion

The main advantage of the new British Act is that it gives protection to innocent third parties acting in good faith who can now enforce a contract against a company even if ultra vires.

As regards constructive notice, the directive clearly states that the doctrine is to be abolished and although section 9 does not expressly state that this is to be so, it can probably be inferred from the provision in section 9(1) dealing with actual knowledge of the public documents.

The wording of the British Act could give rise to certain difficulties. The third party must be 'dealing' with the company and thus appears to exclude the recipient of a gratuitous payment in the form of a charitable gift.

The requirement of 'good faith' is not a general requirement of English contract law and is an uncertain terms. "It is suggested that lack of good faith encompasses more than actual knowledge and understanding of the public documents . . . and it is difficult to see what is involved short of actual fraud."[37]

Section 9 says that the transaction must be 'decided upon by the directors', not that the 'activity' or 'objects' must have been so decided. Thus even if there has been a delegation of power to an individual, the wording of 9(1) might indicate that for a third party to succeed the actual transaction must be ratified by the Board. As well, where a company is required to have more than one director, it is unclear whether 9(1) requires a decision to be taken by all such directors or merely the minimum number constituting the proper instrument of management.

Thus even the one area where the British Act attempted to obviate some of the ultra vires problems-- between the company and third parties, awkward use of language could lend to problems and,"it seems likely at any rate that pernickety liquidators, clever counsel and pessimistic judges will get plenty of mileage out of these words."[39]

The British statutory response therefore does little to change the common law position of ultra vires except where a person dealing with a company finds his position affected by some want of capacity on the part of the company or of its officers, and even there, the Act imposes some obstacles for the third party to overcome. As well, the Act does nothing to counteract the shift in corporate power to the management as noted in the Jenkins Report and does not codify any form of statutory relief for the third party or the investor.

(d) The U.S. Reforms

Introduction

For the purposes of this paper, it can be assumed that the main facets of the Ultra Vires Doctrine as developed in Britain and Canada were similarly adopted in American jurisprudice. "The decision of the House of Lords in Ashbury Railway was influential in bringing about the adoption by the Supreme Court of the United States of the so-called 'federal rule' that ultra vires contracts are void because the corporation does not have legal capacity to make them."[39] The doctrine has also been adopted by the state courts although according to Lattin on Corporations,[40] there are two major differences

(1) the shareholders, by unanimous action may authorize or ratify ultra vires transaction so as to make them valid;
(2) once an ultra vires transaction has been fully performed by one of the parties, the other may sue upon the contract and does not have to rely upon a quasi-contractual remedy.[41]

Legislative reforms

Reform of the Ultra Vires Doctrine began in the U.S. as early as 1915. All the approaches are retentionist in nature but vary somewhat in the approach and language of each response. Using the classification developed by Ham[42] in his article on ultra vires legislation, there are basically four legislative approaches to this doctrine:

(i) Uniform Business Corporation Act 1927

> **§ 11. Corporate Capacity and Corporate Authority; the Same Distinguished.**—I. A corporation which has been formed under this Act, or a corporation which existed at the time this Act took effect and of a class which might be formed under this act, 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.
>
> II. Without limiting or enlarging the grant of authority contained in subdivision I of this Section, it is hereby specifically provided that every such corporation shall have authority:
>
> (a) to have a corporate seal and to alter the same at pleasure;
>
> (b) to continue as a corporation for the time limited in its articles of incorporation, or, if no such time limit is specified [then perpetually];
>
> (c) to sue and be sued in its corporate name;
>
> (d) to acquire, hold, sell, dispose of, pledge or mortgage any such property as its purpose may require, subject to any limitation prescribed by law or the articles of incorporation;
>
> (e) to conduct business in this State and elsewhere as may be permitted by law; and
>
> (f) to dissolve and wind up.[43]

The approach of this Act is that a corporation can commit an unauthorized act. Under this section, a corporation is recognized as having the inherent capacity of natural persons, but its authority to act is limited. As well, the Uniform Act specifically abolishes the doctrine of constructive notice as it applies to corporations. As between a corporation and third party, basic principles of agency apply so that an unauthorized contract would be valid as long as the third party did not know or ought not to have known that the act was unauthorized. The common law doctrine remained in effect in all other cases, the Law Commissioners deciding that "further legislation than this in connection with the ultra vires problem seems to be unnecessary."[44]

(ii) The Minnesota Corporation Act

The major difference in this approach is that only a third party with actual knowledge is precluded from asserting the limited capacity of a company. Thus a person who 'ought' to have known, but did not, can rely on this section.

It should also be noted that, as between the corporation and third persons the defense is available only to the corporation and not to the third party.

301.12 Ultra vires acts

Every corporation shall confine its acts to those authorized by the statement of purposes in the articles of incorporation and within the limitations and restrictions, if any, contained therein, but shall have the capacity possessed by natural persons to perform all acts within or without this state.

No claim of lack of authority based on the articles shall be asserted or be of effect except by or on behalf of the corporation (a) against a person having actual knowledge of such lack of authority, or (b) against a director or officer.

The provisions of this section shall not affect:

(1) the right of shareholders or the state to enjoin the doing or continuing of unauthorized acts by the corporation; but in such case the court shall protect or make compensation for rights which may have been acquired by third parties by reason of the doing of any unauthorized act by the corporation; or

(2) the right of a corporation to recover against its directors or officers for violation of their authority.

Amended by Laws 1965, c. 504, § 3, eff. May 21, 1965. 45

(iii) The California Response

The California Act spells out in great detail the basic thrust of the retentionist type of approach and most effectively ends the claim of corporate limitation between the corporation and the third party.

§ 803. Effect of articles on authority of officers and directors; ultra vires acts

(a) As between corporation and its officers, directors, and shareholders; proceedings in which ultra vires may be asserted. The statement in the articles of the objects, purposes, powers, and authorized business of the corporation constitutes, as between the corporation and its directors, officers, or shareholders, an authorization to the directors and a limitation upon the actual authority of the representatives of the corporation. Such limitations may be asserted in a proceeding by a shareholder or the State, to enjoin the doing or continuation of unauthorized business by the corporation or its officers, or both, in cases where third parties have not acquired rights thereby, or to dissolve the corporation, or in a proceeding by the corporation or by the shareholders suing in a representative suit, against the officers or directors of the corporation for violation of their authority.

(b) As between corporation or shareholder and third persons. No limitation upon the business, purposes, or powers of the corporation or upon the powers of the shareholders, officers, or directors, or the manner of exercise of such powers, contained in or implied by the articles or by Part 9 of this division shall be asserted as between the corporation or any shareholder and any third person.

(c) Validity of contracts and conveyances. Any contract or conveyance made in the name of a corporation which is authorized or ratified by the directors, or is done within the scope of the authority, actual or apparent, given by the directors, except as their authority is limited by law other than by Part 9 of this division, binds the corporation, and the corporation acquires rights thereunder, whether the contract is executed or wholly or in part executory.

(d) Foreign corporations. This section applies to contracts and conveyances made by foreign corporations in this State and to all conveyances by foreign corporations of real property situated in this State. (Stats.1947, c. 1038, p. 2319, § 803.)[5]

(iv) The Model Business Corporation Act

The Model Business Corporation Act is the accepted approach to the ultra vires problem at present for over one-half of the American states and also was the basis for the Australian and the Ontario amendments.

¶ 1. MODEL ACT PROVISION

§ 7. DEFENSE OF ULTRA VIRES

No act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that the corporation was without capacity or power to do such act or to make or receive such conveyance or transfer, but such lack of capacity or power may be asserted:

(a) In a proceeding by a shareholder against the corporation to enjoin the doing of any act or the transfer of real or personal property by or to the corporation. If the unauthorized act or transfer sought to be enjoined is being, or is to be, performed or made pursuant to a contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the proceeding and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing may allow to the corporation or to the other parties to the contract, as the case may be, compensation for the loss or damage sustained by either of them which may result from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a loss or damage sustained.

(b) In a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or through shareholders in a representative suit, against the incumbent or former officers or directors of the corporation.

(c) In a proceeding by the Attorney General, as provided in this Act, to dissolve the corporation, or in a proceeding by the Attorney General to enjoin the corporation from the transaction of unauthorized business.[47]

Discussion

The four approaches are given here in chronological order and they reflect the sophistication of the legislation over the years.

The first two approaches attempt to treat the problem in isolation by eliminating the doctrine only as between third parties and the company and only in limited situations--based on knowledge requirements.

The later legislative treatments of ultra vires culminating in the Model Act also began to develop the motion of protecting the shareholders by allowing them to bring suit against the directors and officers based on their violation of authority, although the doctrine remains in effect as towards shareholders and the company. The Model Business Corporation Act although preserving the rights of shareholders or the state to enjoin the doing or continuance of unauthorized acts, provides that in such cases that the court shall protect or make compensation for rights which may have been acquired by third parties. This approach has been criticized by those who believe that the third parties should have prime consideration in terms of protection:

> Does it not seem an outrage upon the third party to make a contract authorized by the directors binding on him, but not on the corporation if the corporation can persuade some shareholder to bring suit for an injunction and recession? This enables the corporation to speculate at the expense of the third party and deprives a third party contracting with a corporation in good faith of the anticipated profits of his partly executed contract, while reserving a right to such profits to the corporation.[48]

If, however, we accept that shareholder protection is as important as third party protection, then Professor Ballantine's argument is not compelling in that it seems best to leave it to the courts to balance the interests of the shareholders and third parties in any individual case. However, one state (North Carolina) has sought to meet the criticism by forcing the shareholder to prove that in bringing the action he is not acting in collusion with officials of the corporation.

The Model Business Corporation Act represents the accepted modern day retentionist approach and does manage to

provide third party protection, as well as limited shareholder protection. By not recognizing the importance of protecting the interests of the shareholders, even the Model Act leaves glaring areas of non-protection.

(e) Australia - Uniform Australian Companies Act 1961, s. 20

The 1961 Australian Companies Act reform of *ultra vires* is based on the Model Business Corporation Act and is very similar to the current Ontario legislation. Thus, it will be necessary only to discuss the differences between this Act and the Ontario one, because the Ontario Act will be dealt with in detail later in this section.

> **20.** (1) No act of a company (including the entering into of an agreement by the company) and no conveyance or transfer of property, whether real or personal, to or by a company shall be invalid by reason only of the fact that the company was without capacity or power to do such act or to execute or take such conveyance or transfer.
>
> (2) Any such lack of capacity or power may be asserted or relied upon only in—
>
> (*a*) proceedings against the company by any member of the company or, where the company has issued debentures secured by a floating charge over all or any of the company's property, by the holder of any of those debentures or the trustees for the holders of those debentures to restrain the doing of any act or acts or the conveyance or transfer of any property to or by the company;
>
> (*b*) any proceedings by the company or by any member of the company against the present or former officers of the company; or
>
> (*c*) any petition by the Minister to wind up the company.
>
> (3) If the unauthorized act conveyance or transfer sought to be restrained in any proceedings under paragraph (*a*) of sub-section (2) of this section is being or is to be performed or made pursuant to any contract to which the company is a party, the Court may if all the parties to the contract are parties to the proceedings and if the Court deems it to be just and equitable set aside and restrain the performance of the contract and may allow to the company or to the other parties to the contract (as the case requires) compensation for the loss or damage sustained by either of them which may result from the action of the Court in setting aside and restraining the performance of the contract but anticipated profits to be derived from the performance of the contract shall not be awarded by the Court as a loss or damage sustained.

Section 20(2)(a) allows both a shareholder and a floating charge debenture holder to assert lack of capacity against a company thus allowing for more statutory protection for third parties than is allowed by Ontario.

On the other hand, the Ontario Business Corporation Act, by s. 16(1)(a) goes much further in whom it allows to bring the action than does the Australian Act, which by s. 20(2)(b) allows the claim to be made by the company or by any member of the company only.

The Australian Act does not contain the 'otherwise lawful' phrase which, as it will be noted, could give rise to problems due to its use in the Ontario Act.

In all other areas, the Ontario and Australian approach are the same. Refer to the discussion on the Ontario Business Corporation Act for further discussion.

(f) Israel

In 1967-68 the Company Law Reform Committee of Israel considered the problem of Ultra Vires and developed recommendations for reforming the doctrine which basically fits into the general 'retentionist' approach.[49] For our purposes it is only necessary to briefly discuss the variations in the Israeli report as compared to the other approaches in this section.

The Committee recommended that absolute liability be imposed upon the directors for any damage caused to the company as a result of an ultra vires act. Another recommendation was to extend the existing law by granting credotprs a right to apply to the court for an injunction to prevent a company from carrying out an ultra vires act. This position is also being advocated in many Canadian approaches so the

rationale for this recommendation is interesting. Basically, the Committee accepted the two-fold rationale of the doctrine--protection of the shareholder and protection of creditors. They felt that in order to introduce logic into the law, the protection provided for one party should also be extended to the other.

One commentator on the Committee's recommendation raised one possible argument regarding this point--by granting such a right to the creditor, he would be able to interfere in the activities of the company. He responded to the argument in this way:

> However strong this argument may be it does not apply only to a creditor. By granting a right to a shareholder to prevent the company from acting ultra vires, there is interference in the company's business and we nevertheless recognize the right of a shareholder to an injunction.[50]

(g) The Lawrence Report

The chapter of the 1967 Interim Report of the Select Committee on Company Law (Lawrence Report) which deals with capacity and ultra vires is ambiguous and does not set out the reasoning behind the decisions of the committee. Basically, the Committee concluded that acts of a company should not be held ultra vires as regard third parties, if done in contravention of some limitation or prohibition in the company's charter.

The draft legislation suggested by the Committee:

> "Every corporation (a) has and shall be conclusively deemed to have had from its incorporation the capacity of a natural person, and that capacity, as regards third parties, is not limited by the terms of its charter; and (b) may exercise its powers beyond the boundaries of Ontario to the extent permitted by the laws in force where the powers are sought to be exercised, and may accept extra-provincial powers and rights."

As well, the Committee recommended that the doctrine of constructive notice be abolished as it might relate to ultra vires

Discussion

The Lawrence Report attacks the ultra vires problem in the two areas where the problems can be effectively removed--capacity and constructive notice. However, the Committee chose to follow a retentionist approach with the result that shareholder will still be bound by the doctrine and the lack of protection it affords.

It should be noted that in Chapter VII of the report, the Committee recommended a codification of a right which would provide that individual shareholders "may sue for the enforcement of individual rights including compliance with the provisions of the company's charter and by-laws." However, with the use of the various drafting techniques available to circumvent the effects of the objects clause, this shareholder action will be of little effect.

The Lawrence Report does not provide in its recommendations any statutory protection for third parties so that third party rights are based purely on common law and agency principles. It seems unlikely that these common law rights are powerful enough to counterbalance the large amount of power which will be concentrated in the hands of management, who will now be able to run a company unfettered by any restraints in corporate capacity.

(h) Ontario Business Corporation Act, R.S.O. 1970

Ontario was the first Canadian jurisdiction to attempt to reform the Doctrine of Ultra Vires. Section 16 of the

Ontario Act is the statutory embodiment of the Ontario retentionist approach:

> **16.** (1) **Acting outside powers.**—No act of a corporation and no transfer of real or personal property to or by a corporation, otherwise lawful, that is heretofore or hereafter done or made, is invalid by reason of the fact that the corporation was without capacity or power to do such act or make or receive such transfer, but such lack of capacity or power may be asserted,
>
> (a) in a proceeding against the corporation by a shareholder under subsection (2);
>
> (b) in a proceeding by the corporation, whether acting directly or through a receiver, liquidator, trustee or other legal representative or through shareholders in a representative capacity, against a director or officer or former director or officer of the corporation; or
>
> (c) as cause for the cancellation of the certificate of incorporation of the corporation under section 250.
>
> (2) **Restraining order.**—A shareholder of a corporation may apply to a court of competent jurisdiction for an order to restrain the corporation from doing any act or transferring or receiving the transfer of real or personal property on the ground that the corporation lacks capacity or power for the purpose, and the court may, if it considers it to be just and equitable, grant an order prohibiting the corporation from doing the act or transferring or receiving the transfer of the real or personal property, but, where the act or transfer sought to be restrained or prohibited is being or to be done or made under a contract to which the corporation is a party,
>
> (a) all the parties to the contract shall be parties to the proceeding;
>
> (b) the court in granting the order may set aside the contract and allow the corporation or other parties to the contract, as the case may be, such compensation as may be equitable for the loss or damage sustained by any of them from the granting of the order and setting aside of the contract, other than anticipated profits from the contract. 1970, c. 25, s. 16.

Although it is not made express in the Ontario Act, s. 16(1) seems to contemplate an abolition of the constructive notice doctrine as regards creditors and third parties.

As noted earlier, the Ontario Act was based to a large extent on the U.S. Model Business Corporation Act and contains very little resemblance to the draft legislation as formulated by the Lawrence Committee.

Discussion

In section 15, the Ontario Act attempts to maintain the provision which sets out all the possible powers a company may have. Coupled with the fact that objects clauses must be registered, this will perpetuate the confusion and inadequacy of listing objects and powers in this way.

The ultra vires section contains the ambiguous phrase--'otherwise lawful' which is not defined anywhere in the Act. Iacobucci suggests that the words refer to the "lawfulness of the Act in the sense that, for example, it does not have an object which is void for public policy, or if it is a contract, it does not possess any other vitiating factor such as a lack of consideration".[51] In referring to the 'otherwise lawful' phrase, the Interim Report for the Department of Consumer Affairs in Alberta, suggests it "probably refers to doctrine of contract other than ultra vires and is thus superfluous, but its inclusion in the section leaves some doubt as to the proper interpretation."[52]

As far as third party protection is concerned, the Ontario Act abolishes ultra vires but does not codify any statutory protection for third parties. A creditor must find his legal remedy in the common law. In this context, the Australian Act should be noted because in that Act which is very similar to the Ontario Act with regards to their treatment of ultra vires under the equivalent of section 16(2), a debenture holder may also bring an action.

With regards to shareholder protection, the B.C.A. draftsmen decided that retention of the doctrine would be the best way to protect investors. Section 16(2) allows the shareholder to restrain a company from exceeding its

capacity and s. 99 condifies a representative action by a shareholder on behalf of the company to enforce any duty (which presumably includes the contractual duty between the company and the shareholders as specified by the objects) owed to the corporation. These statutory safeguards however are based on a fallacy that the object clause in the memorandum actually protects the shareholder in terms of restraining a company from acting outside its capacity. As has been noted numerous times in this paper, the objects clause does not provide those safeguards, and it follows that the various statutory protections are meaningless in this context. As Getz remarked when discussing the Ontario Act: "The problem has been approached in a curiously faint-hearted and circuitous fashion, and ultra vires, far from being dead in Ontario, may well have entered upon a new and more vigorous life."[53]

(i) Draft Ghana Code[54]

Professor Gower, the architect of the draft legislation for Ghana's Company Code favours the retentionist approach fo the reason that he believes a shareholder has the right to know the way in which a company is going to spend the money he has invested in it and an object clause is one of the easiest ways to inform potential investors. However, unlike the other retentionist approaches, Gower's solution does indeed seem to establish a way to balance the interests of both shareholders and creditors.

25. (1) A company shall not carry on any business not authorised by its Regulations and shall not exceed the powers conferred upon it by its Regulations or this Code.

(2) A breach of subsection (1) of this section may be asserted in any proceedings under section 210, 218 or 247 of this Code or under subsection (4) of this section.

(3) Notwithstanding subsection (1) of this section, no act of a company and no conveyance or transfer of property to or by a company shall be invalid by reason of the fact that such act, conveyance or transfer was not done or made for the furtherance of any of the authorised businesses of the company or that the company was otherwise exceeding its objects or powers.

(4) On the application of—

(a) any member of the company, or

(b) the holder of any debenture secured by a floating charge over all or any of the company's property or by the trustee for the holders of any such debentures,

the Court may prohibit by injunction the doing of any act or the conveyance or transfer of any property in breach of subsection (1) of this section.

(5) If the transactions sought to be prohibited in any proceedings under the immediately preceding subsection are being, or are to be, performed or made pursuant to any contract to which the company is a party, the Court may, if it deems the same to be equitable and if all the parties to the contract are parties to the proceedings, set aside and prohibit the performance of such contract, and may allow to the company or to the other parties to the contract compensation for any loss or damage sustained by them by reason of the setting aside or prohibition of the performance of such contract but not compensation for loss of anticipated profits to be derived from the performance of such contract.

In conjunction with s. 25, s. 141 of the Draft Act abolishes constructive notice as it applies to ultra vires

Discussion

This section was based on the American Model Business Corporation Act. The major difference in this section is that under s. 5(4)(b), it enables action to be taken by certain types of debentureholders as well as by members. The reasoning for this extension is that to Gower, a debenture holder closely resembles certain types of shareholders such as preference shareholders.

Without going any further, Gower's approach would not have differed significantly from the other retentionist approaches. However, Gower apparently recognized the ineffectiveness in using modern day objects clauses for protection and therefore devised a way to hopefully restrict the use of the object clause for the purpose it was originally designed to serve.

247 (2) The Court may order the winding up of a company on such petition if:—

(a) the company does not within a year from its incorporation commence to carry on all the businesses which it is authorised by its Regulations to carry on or suspends any of such businesses for a whole year;

His commentary:

> 4. Accordingly, I think it is essential to limit the nature of the businesses which a company may carry on. But how is one to prevent this requirement being evaded by stating in the Regulations every conceivable business that the promoters can think of ? If this is allowed, " objects clauses " will continue to be unduly lengthy and the protection of investors will be illusory.
>
> My suggested solution is to provide that it shall be a ground for winding up that a company has not commenced *all* its authorised businesses within a year or has ceased to carry on any authorised business for more than a year: *see* section 247 (2). This will make it essential only to specify businesses which the company really intends to start immediately. If, later, it wants to engage in others it will have to change its Regulations under section 26 and, for this purpose, to consult its members. Similarly if it wants to abandon any authorised object it will have to change its Regulations and, again, to obtain the concurrence of its members. Hence only one or two businesses are likely to be authorised at any time and the present abuse, whereby wide objects clauses enable the directors to bring about a complete change of business without consulting their shareholders, should be prevented.

Gower also notes that this power to wind up is essentially 'in terrorem' to ensure that an excessive number of businesses are not authorized. In conjunction with this proposal, Gower also recommends a much simpler method by which a company can alter its objects clause (see s. 26 and commentary).

Gower's solution would seem to be sound theoretically. His main criticism of the 'abolitionist approach' is that he believes investors should be told the nature of the business in which they are investing and that the directors should not be allowed to change this at their whim and pleasure. "It would discourage, rather than encourage, investment if the ultra vires rule were scrapped completely."[54a] If we accept this assumption (which the abolitionists do not), Gower's solution would indeed have the desired effect of cutting down the objects clause and probably (although this is not made express in his Code) would eliminate the director's opinion clauses.

There is one important criticism to be made of Gower's proposed solution--its workability. In order to institute this kind of system, one must ask--How will it work? How will it be enforced? To ensure that companies are adhering to the

law will require a great deal of supervision and investigation. The large financial cost and the obvious distaste for governmental interference in the business community in this area might make this solution less than appealing to an Alberta government.

It should also be noted, that a company might easily avoid this kind of provision by diversification or incorporation of wholly-owned subsidiaries to carry out businesses in other areas.

The Draft Ghana Code makes two other changes which seem to be positive advances in this area.

> **24.** Except to the extent that the company's Regulations otherwise provide, every company registered after the commencement of this Code and every existing company which, pursuant to section 19 of this Code, adopts Regulations in lieu of its memorandum and articles of association shall have, for the furtherance of its objects and of any business carried on by it and authorised in its Regulations, all the powers of a natural person of full capacity.

This change adds brevity, simplicity and certainty into the law and is to be recommended in any proposed reform of the ultra vires doctrine.

Gower's code also goes much further in the area of statutory remedies than any of the other retentionist approaches. Section 217 allows a shareholder to restrain a company from entering into a transaction beyond its capacity although this section is subject to the ultra vires section and therefore the rights of third parties (thus eliminating Professor Ballantine's criticism of the U.S. approach discussed earlier).

More importantly, section 218 allows any member or debentureholder to apply to a court for any one of a number of orders, on the ground

> **(a) that** the affairs of the company are being conducted or the powers of the **directors** are being exercised in a manner oppressive to one or more of the **members** or debentureholders or in disregard of his or their proper interests **as** members, shareholders, officers, or debentureholders of the company; or
>
> **(b) that** some act of the company has been done or is threatened or that some **resolution** of the members, debentureholders or any class of them has been **passed** or is proposed which unfairly discriminates against, or is otherwise **unfairly** prejudicial to, one or more of the members or debentureholders.

This section, adapated from British Acts, provides for protection of both the minority shareholder and certain types of third party creditors, who, as Gower points out in his commentary, "often need some means of bringing to an end a course of conduct which without being definitely illegal, is nevertheless oppressive."[55] This remedy would prove to be of great value in the area of ultra vires as it would provide for increased protection for both shareholders and third parties.

Contrary to a criticism levelled at other retentionist approaches, i.e., that too much power is being concentrated in the hands of management, it has been argued that Gower's Code places unreasonable restrictions upon management and may thus operate against the interest of the shareholder in the company by preventing development in new and profitable directions.

Getz, who favours the Gower proposals answers this criticism in two ways:[56]

(1) It does not necessarily follow that the pursuit of a new direction in the company is consistent with the obligations of the directors to act bona fide in the best interests of the company as a whole.

(2) Getz argues that the kind of argument as enumerated above "involves the paternalistic assumption at best arguable, that the directors know best what is good for the shareholder."[57]

G. APPROACHES TO REFORM OF THE ULTRA VIRES DOCTRINE II: THE ABOLITIONISTS

(1) Introduction

The abolitionist approach is a new approach to the ultra vires problem and is up to now, largely a Canadian response. The major feature of this approach is that the doctrine is abolished as between the company and both third parties and shareholders so that a company has the powers and capacities of a natural person for all purposes.

(2) General Advantages and Disadvantages

Gower succinctly stated the major assumption which underlies the retentionist approach:

> It seems to me that investors should be told the nature of the business in which they are investing and that the directors of the company should not be allowed to change this at their whim and pleasure. The nature of a partnership business cannot be changed without the consent of all the partners and, similarly, if a shareholder has invested in a gold mine he should not be forced to participate instead in the running of a fried fish shop. It would, I think, discourage rather than encourage, investment if the *ultra vires* rule were scrapped completely.[54]

This assumption however, is not acceptable to the abolitionists who argue that the objects clause is not the best mechanism by which shareholders or investors can be protected. They believe that realistically, a potential investor examines other more important facets of the company in coming to their eventual decision as to whether they will invest in a company. A good example of the abolitionist approach is illustrated by this passage from the Thompson article:

> Modern objects clauses are framed in such a way that companies, and thereby directors, are already possessed of such wide powers that the information contained in the objects clause is of little practical value. How many persons, in assessing the investment potential or creditworthiness of a particular company, investigate the company's objects, and, if they do, how much significance do they attach to their findings? Much more powerful and influential factors are the company's financial record, the field of activity

> in which it is engaged at the time, the reputation of its management, and published statements of its current progress and future prospects. Although these factors might not be available for consideration in the case of an entirely new company, investment in such a company would be essentially speculative without a personal knowledge of and faith in the promoters and first directors, and would not be made less so by reliance on the nebulous provisions of a widely drafted objects clause.

Thus the abolitionists put very little faith in the object clause and many see the object clause merely as a valuable instrument for deceit on the part of the company. As Dickerson, a leading advocate of this approach, argues:

> The combined effect of . . . (the abolitionist approach) then, is to make the articles of incorporation much simpler, and far less likely to deceive. An incidental result will be that anyone reading articles of incorporation will immediately realize that they cannot be relied upon for information as to the business actually being carried on by the corporation, and that further inquiries will have to be made. This, in our view, is a positive advance.[59]

The main advantage of the abolitionist approach is that it attacks the ultra vires problem in the major problem area of capacity and thus tends to eliminate ultra vires for all purposes. Naturally, by eliminating the doctrine, other safeguards must be created to replace ultra vires so as to give the third party and shareholder the protection for which the doctrine was originally created. It is in this area that the notion of statutory remedies becomes important. The broader and more wide ranging the statutory remedy, the greater the protection.

The abolitionist apporach does tend to centralize an even greater amount of control and power in the hands of the directors and the management, and it is in this area where controls are required to prevent abuse and we will examine

the controls individually by approach in this section.

With the doctrine of Ultra Vires abolished reformers had to find new means of protection for shareholders and third parties to act as a counter influence to the vast power which will now be concentrated in the hands of management. As will become apparent as we study the individual approaches, the solution offered by most abolitionists is to allow shareholders and third parties easier access to the courts and allow the courts to use their discretionary powers to offset management control.

This approach can be criticized by those who argue that inpractical terms, courts are not the place where these issues should be resolved due to the time factor, cost and inexpertise of the judiciary. Such a broadening of the role of the court in this area will naturally result in problems initially, but it is hoped that they can be overcome. As long as the judiciary is willing to take a firm role in this area, it is submitted that the courts could develop the expertise which is required and can effectively provide the necessary protection far more effectively than could any other group.

The abolitionist approach forms the basis of one major report (The Dickerson Report), the new Federal Act, the new B.C. legislation and proposed reform to the New Brunswick Companies Act. This section will now examine each of those responses in some detail.

(3) Discussion of Individual Approaches

(a) The Dickerson Report

One of the major themes running through the Dickerson

Report is the principle of maximum flexibility in a corporation--the allowance of complete freedom to structure the corporation to suit the wishes of the shareholders. The approach of the Committee to ultra vires reflects this approach by allowing a corporation to be formed for any lawful purpose, and to carry on any business it may choose, and for the corporation's internal organization to be governed in any way the shareholders see fit.

The Dickerson Committee concluded that in terms of achieving a desired goal, "the protection afforded to those whom the doctrine was designed to protect have been minimal". They further concluded that the requirement of object clauses and their registration, served only to confuse and mislead those who the doctrine was designed to protect.

In deciding which was the best approach to take, the Committee considered the crucial question of how they could best balance the interests of shareholders and creditors and ultimately rejected the retentionist approach--even that as formulated by the Gower Draft Ghana Report:

> We do not think that there is any practicable techniques, through the medium of a corporation statute, for ensuring that only those businesses that are described in an 'objects' clause that the corporation actually intends to carry on. Experience has demonstrated this. Any such requirement can be readily evaded, either by suitable drafting or through the use of power to invest surplus funds.[60]

Recommendations of the Dickerson Committee

The Committee adopted a three pronged approach towards eliminating the problems currently existing:

(a) By s. 3.01(1), they deal with the question of capacity, and deem a company to have the legal capacity of a natural person of full legal capacity. The draft legislation allows companies to restrict in its articles, the kind of business it wants to carry on (s. 3.02(2)) and for an application to court by a shareholder, or a creditor for a restraining order to prohibit the company from entering into a transaction outside its own restrictions (s. 303).

(b) Under the draft legislation, the articles of incorporation are simplified and the 'objects' clause is eliminated. If a company places no restrictions on itself, there is no need to register the kinds of business it is carrying on.

(c) Constructive notice is abolished in most cases, leaving it open to the courts however to apply the doctrine if there is good reason for so doing (s. 3.04).

The effect of these three reforms is that the Ultra Vires Doctrine is effectively abolished in full. Companies have full capacity and in the event they place restrictions on themselves and then exceed those restrictions, either a shareholder or a creditor can apply to a court and the court has wide powers to protect the interests of all the parties involved.

The Dickerson Report also recommended that by s. 3.02(1), a corporation would by implication have all the powers of a natural person. This would effectively eliminate the power/capacity confusion so that there is no need to deem powers to companies or require that companies register them.

The doctrine of Ultra Vires was not created in a vacuum and the authors of the draft legislation were required to formulate some new responses in order to maintain a reasonable

balance of power between management and the shareholders to ensure that the directors do in fact act in the interests of the company and its shareholders.

It should first be noted that if a company contravenes its own restrictions, either a shareholder or a creditor, by s. 3.03 may apply to court. 'Creditor' is not defined and it is uncertain whether it applies to unsecured as well as secured creditors. As well in circumstances where there are no restrictions on a company's capacity, the shareholder and third party are given new remedies along with their common law rights in agency, or a shareholder's right to petition for a winding up of the company.

Section 19 of the Draft Act contemplates at least three possible methods by which 'complainants' may bring an action against the company: (The term 'complainant' is defined so as to encompass shareholders, security holders and any other person the court thinks is a proper person to participate in the litigation.)

(a) s. 19.02 is the statutory derivative action and allows the complainant to apply to a court to intervene on behalf of the corporation to enforce a right of the corporation.

(b) s. 19.10 empowers a court or a complainant to compel a director, officer, employee, agent or auditor of corporation to comply with the Draft Act, the regulations, the articles, by-laws, etc.

(c) S. 19.04 is a new remedy and it is designed to protect complainants by allowing an application to a court for any of a number of orders to restrain the company from carrying on business in an 'oppressive' or 'unfairly prejudicial' way:

19.04

(1) A complainant may apply to a court for an order under this section.

(2) If upon an application under subsection (1) it appears to the court that in respect of a corporation or any of its affiliated corporations

(a) any act or omission of the corporation or any of its affiliates effects a result,

(b) the business or affairs of the corporation or any of its affiliates have been carried on or conducted in a manner, or

(c) the powers of the directors of the corporation or any of its affiliates have been exercised in a manner

that is oppressive or unfairly prejudicial to or in disregard of the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

It is obvious that the intention of this kind of remedy is to provide a broad framework which will serve as a counter balance to the vast powers of the management, and effectively protect the interests of the minority shareholders or a third party dealing with the company. "In sum, we think that the courts should have very broad discretion, applying general standards of fairness, to decide these cases on their merits." Thus the judiciary have the major responsibility to maintain an effective counterforce to management control.

(b) The Canada Business Corporation Act

For the most part, the new federal Act has adopted the major recommendations of the Dickerson REport and utilized an abolitionist approach to the Ultra Vires Doctrine.

Section 15(1) is the section dealing with corporate capacity and it states in very clear terms:

Capacity of a corporation

15. (1) A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person.

In conjunction with this, a federal company need not register its object clauses although the company itself has the right to restrict itself in the business it may carry on or the powers it may exercise (s. 16(2)). However s. 16(3) ensures that ultra vires is abolished so that even if a company exceeds the restrictions it has placed on itself, the transaction is not invalid and the aggrieved party will be protected by the actions contemplated in s. 232 and s. 234 which he may undertake. Section 17 abolishes the Constructive Notice Doctrine in this context unless under s. 18, the person had or ought to have had the special knowledge in question

Discussion

The federal Act effectively abolishes the Ultra Vires Doctrine for all purposes, and in line with the Dickerson Recommendations has adopted the use of judicial discretionary remedies to take its place. Those who can bring actions on behalf of, or against the company comprise a broad group as defined in s. 231 and the actions which a complainant may bring are also broad in nature. Section 232 is the statutory derivative action and s. 234 is the new 'oppressive or unfairly prejudicial' remedy--both of which are available to third parties, shareholders and anybody else the court deems fit to allow to apply.

The Act does not contain a remedy based on s. 3.03 of the Draft Act which allowed an application to court to restrain, set aside or compensate any party if the corporation entered into a transaction which exceeded any restrictions the corporation itself placed on its articles. It is submitted however, that this kind of an action would be covered under section 234. (NOTE: a section similar to s. 3.03 was adopted for use in the new B.C. legislation--see s. 27.)

(c) The British Columbia Companies Act

The B.C. Legislation dealing with ultra vires was the first abolitionist approach to become law in Canada. On the whole, the provisions of the B.C. Act are effective in eliminating the ultra vires doctrine, its problems in most areas but there are a few criticisms to be noted.

Section 23(1) is the section dealing with ultra vires and like the Federal Act, the statement of the law is brief, simple and deals with the problem at its root--in terms of capacity.

> 23.(1) Subject to subsection (2), a company has the power and capacity of a natural person of full capacity.

Note also that s. 23(1) will effectively clear up any confusion between a company's powers and objects although notwithstanding s. 23(1), s. 35 gives to companies certain explicit powers and s. 36 deals with extra-territorial powers of a company.

The B.C. legislation on ultra vires was designed to be retroactive and the legislatures in s. 25 have found an efficient way of handling this:

> **25.** Where the words "The objects for which the Company is established are", or words of like effect, are contained in the memorandum of a company incorporated before the coming into force of this Act, other than a specially limited company, those words shall be deemed to be struck out and the words "The businesses that the Company is permitted to carry on are restricted to the following" shall be deemed to be substituted therefor.

A pre-1973 company or a company incorporated after this Act had gone into effect may also restrict its objects or powers in any way it sees fit (see s. 24(1) and 24(2)) but s. 24(3) ensures that an act is not invalid merely because it exceeded those restrictions and s. 27 allows an application to court by a member, receiver, receiver-manager, liquidator or trustee to restrain, compensate or make any other order it considers necessary to prohibit a company from entering into such a transaction.

By s. 28, Constructive Notice is abolished. Moreover, even actual knowledge of the contents may not adversely affect a third party's position if he acted honestly and reasonably.

In line with these developments, the requirements of an object clause have been eliminated save for any restrictions a company inserts into its articles.

Under this Act, directors will face increased liabilities for acts which are not authorized or allowed by the memorandum. In this respect s. 24(3) should be read with s. 131(3), that is to say, a director of a company is required to comply with the memorandum and articles of a company.

Discussion

Although the approach of the B.C. legislation is abolitionist, there is one area in the Act where ultra vires might again 'rear its ugly head'--s. 23(2), which deals with activities a B.C. company cannot engage in. The wording of this section is in terms of corporate capacity and thus the common law regarding corporate capacity, i.e., ultra vires, will be in effect, along with its inherent defects and problems.

(2) No company has the capacity
- (a) to operate a railway as a common carrier; or
- (b) to carry on the business of insurance, except as authorized by clause (d) of subsection (1) of section 35; or
- (c) to operate as a club, unless authorized in writing by the Attorney-General; or
- (d) to carry on a business that is trust business as defined in Schedule A of the *Trust Companies Act*. 1973, c. 18, s. 23.

There are numerous alternate methods of achieving this same goal without speaking in terms of corporate capacity. Slutsky in his article[63] on the B.C. approach suggests that it simply be stated that a company has full capacity to carry on any business, but if it emgages in any of the activities set out in s. 23(2) it would be liable to have its certificate of incorporation cancelled and be struck off the register, without prejudice to the rights acquired by parties prior to the date on which the company is dissolved. This solution might however cause administrative hardships. A much more simpler solution seems to be the one adopted by the new Federal legislation which talks in terms of applicability and not corporate capacity (see s. 3(2)).

In terms of protection of shareholders and third parties, the B.C. legislation is in line with the Dickerson Report in relying on the judiciary to provide the required safeguards. Sections 221 and 222 are the major relief sections. With regards to shareholder protection, the B.C. provisions seem quite adequate. Section 221 allows application to court on an 'oppressive' or 'unfairly prejudicial' basis in order to provide relief to the shareholder himself. Section 222 is the statutory derivative action on behalf of the company. Also, as we noted earlier, s. 27 allows an application by a shareholder to prevent a company from exceeding its restrictions.

However, the B.C. Act is very noticeably dificient in providing statutory remedies for third parties. Unlike the Federal Act which gives the court discretion to allow a third party to bring an action as a complainant, the B.C. Act, in sections 221, 222, and 27 restrict the right to bring an application to 'members' of the company only. Thus, under a s. 27 action, if the 'restricted' transaction is still wholly or partially executory, the third party may well have his contract set aside. Slutsky argues however that

> . . . it seems safe to predict, however, considering the wording and intention of section 27, that no order made pursuant to such an application would seriously prejudice the position of a third party who had been dealing in good faith with the company. He would at least receive compensation from the court.[64]

For the most part however, a third party in B.C. will be forced to rely on agency principles and will have no remedy equivalent to the one enjoyed by third parties who deal with federally incorporated companies.

(d) New Brunswick

New brunswick is the latest Canadian province to issue a Working Paper[65] for reform proposals in Company Law (Feb. 1975). The approach taken by the New Brunswick Report with regards to ultra vires is abolitionist. The report recommends the abolition of ultra vires as regards both shareholders and third parties, no requirements for objects clauses with the option for a company to place its own restrictions on its business activities, and abolition of the doctrine of constructive notice as it relates to ultra vires.

The New Brunswick proposal recommends the codification of a derivative action similar to that proposed by the Dickerson Committee which could be maintained by shareholders, security holders, directors or any other person who, in the discretion of the court, is the proper person to bring the action. However, nowhere in the working paper is there a remedy proposed similar to the 'unfairly prejudicial or oppressive' remedy suggested by Dickerson and adopted in the Federal and B.C. Acts. Thus, there is very little in the way of protection for either shareholders or third parties to offset the large powers which would be concentrated in the hands of management or majority shareholders. With the vast majority of New Brunswick companies being private companies (as is the case in Alberta) this is a serious source of weakness for both minority shareholders and third parties who deal with the company.

Besides this one major omission, the New Brunswick working paper is very similar in approach to the other reports noted in this section.

H. RECOMMENDATIONS AND CONCLUSIONS

This paper has been based on the assumption that it is necessary to provide some sort of protection to shareholders and third parties dealing with a company to ensure that a company does not enter into unauthorized transactions or carry on business beyond its capacity. Originally, the doctrine of Ultra Vires was formulated to provide that protection but as we have seen, that protection is no longer effective today and it is therefore necessary to seek out alternate methods of reform.

Two basic approaches of reform have been formulated and we have discussed the combinations and permutations of each one in detail. It is the opinion of this writer that any reform in Alberta be modelled after the Dickerson Report and on the abolitionist approach. It is recommended that the doctrine of Ultra Vires be abolished as against third parties and shareholders and that Alberta companies be given both the powers and capacity of a natural person.[66] This would in effect remove all questions of corporate capacity and would allow a company to carry on any business it desires or to restrict its activities as it sees fit. However, as in the B.C. and Federal Act no act of a company would be invalid by reason only that it exceeded its restrictions. In conjunction with the above, it is recommended that object clauses be done away with. This would put an end to the confusion and to the misleading information now given by the object clause in order that all parties dealing with the company will know that they must look elsewhere to gain information about the company for investment and commercial purposes. In order to makes these recommendations effective, the Doctrine of Constructive Notice will have to be abolished as it applies to this situation.

With regards to the functional and constitutional limitations which bind Alberta companies, these reforms are recommended:

In terms of extra-territorial capacity of a company, a section similar to s. 36(1) of the B.C. Act would be effective:

> **36.** (1) Every corporation created within the Province has, and shall be deemed to have always had, capacity to carry on its business or exercise its powers outside the Province and to accept powers and rights in respect thereof from any lawful authority outside the Province, except where the operations of a corporation are confined to the Province by some express provision in its charter or an Act of the Legislature.

Refer back to section E.1(b) for a discussion on how best to approach the question of functional limitations for an Alberta company.

Reform in this area will require retroactivity and it is submitted that the method put forward in the B.C. Act in s. 25 will be effective as long as the method by which a company can alter its restrictions is simplified so that companies will not have to apply to court, as they do now in order to change its object clause.

The above recommendations have all been directed towards eliminating what this writer considers a ineffective and out-dated approach in this area. However some kind of replacement mechanism must be formulated in order to provide the necessary balance between third party and shareholder protection. There is no simple solution to this problem however it is submitted that the approach adopted by Dickerson and the other abolitionists is the most satisfactory. The abolitionists have attempted to use the discretionary power of the judiciary as a counterforce to the large powers they have conferred on a company's management in order to provide the required protection. By giving

the courts wide power to make such orders as they think fit it is hoped that the injustices of the Ultra Vires Doctrine will be overcome while at the same time allow a company to operate in our system largely unfettered by costly and burdensome restraints. It is therefore recommended that Alberta adopt the recommendations as proposed by the Dickerson Committee in section 19 of the report. Those remedies include a statutory derivative action (s. 19.02), a statutory remedy whereby a complainant can bring an action if he has been 'unfairly prejudiced' or the victim of 'oppressive treatment' (s. 19.04), and a statutory remedy similar to section 27 of the B.C. Act to restrain a company which is about to exceed the restrictions it has placed on itself.

It is further recommended that in considering who should be allowed to bring these actions, a broad approach should be adopted so that both shareholders and third parties (or anyone who the court deems best to bring the action) have this right. This would tend to maximize the amount of protection given to both shareholders and third parties and balance the interests of both. The success of this approach depends on the judiciary. If they can develop the expertise to deal with complex corporate problems, make their courts accessible to aggrieved parties and win the confidence of the business community, then the proposed system will effectively provide the certainty and justice required.

> In the final analysis, it will depend upon the attitude of the judiciary and the vigilance of the shareholders to offset any increase in managerial authority occasioned by the disappearance of ultra vires.

Alternatively, if the above recommendations are rejected and it is desired to retain the doctrine as between the

company and the shareholders, it is recommended that a reform similar to the Ghana Code should be adopted. It is the only retentionist approach which attempts to cut down the scope of the objects clause and thus prevent the abuse and ineffectiveness caused by that type of clause. As well, the Ghana Code has a broad range of remedies similar to the ones recommended by the Dickerson Report. However, as noted earlier, the effectiveness of this proposal, in terms of it operating in practice are questionable and for that reason it was rejected in favour of the abolitionist type of approach.