

THE COMPANY LAW COMMITTEE RECOMMENDATIONS
ON ULTRA VIRES AND THEIR EFFECT ON THE
DOCTRINE OF CONSTRUCTIVE NOTICE

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I. INTRODUCTION

The purpose of this paper is to examine the doctrine of constructive notice in light of the recommendations made by the Company Law Committee on June 18, 1975, with regards to the Doctrine of Ultra Vires.

At that meeting the Committee recommended that the Ultra Vires Doctrine be abolished as against both shareholders and third parties dealing with the company. In conjunction with this, they recommended that a company no longer need file an objects clause. A company may however, place restrictions on its business activities. The Committee recommended however, that even if a company has exceeded those restrictions and entered into a transaction with a third party outside the scope of those restrictions, the contract will always be valid (assuming it is an executed contract) unless fraud or collusion is found. The shareholder's protection will be in his statutory remedy.

II. WHAT IS THE DOCTRINE OF CONSTRUCTIVE NOTICE?

Under the doctrine of constructive notice, third parties dealing with a company are deemed to have knowledge of and understand the contents of the corporation's publicly registered documents. The doctrine is designed to protect shareholders and the company against the unauthorized acts of corporate agents by deeming notice and knowledge to third parties of all express restrictions and requirements with regard to the corporation's carrying on of a business.

III. CURRENT ALBERTA POSITION

The doctrine is currently in effect in Alberta. Thus a third party is deemed to have knowledge (whether he has actually examined them or not) of a company's object clause.

This means that in effect, the third party is deemed always to know when a company has exceeded its objects and cannot assert against the company an authority inconsistent with those documents.¹

IV. CRITICISM OF THE DOCTRINE

The doctrine was originally designed as a protection for corporate interests against dissipation of its property by the unauthorized acts of its agents. However, it has been greatly criticized as being a doctrine not commensurate with normal business practices. Most businessmen do not consult the 'public' documents before doing business with a company and to 'deem' them to do so does not promote or facilitate smooth commercial activities. It should also be noted that the doctrine currently requires the need for corporate counsel to spend considerable time and money inspecting the documents and requiring certain formalities to be undertaken in order to render the opinion of due authorization at the closing of a transaction.

V. CONSTRUCTIVE NOTICE AND THE ULTRA VIRES RECOMMENDATIONS

- (1) If the Company imposes no Restrictions on its business activities

The Committee recommended that object clauses no longer be required to be included in the memorandum of association. Thus, there is, in effect, nothing for the doctrine of constructive notice to attach to, in terms of objects. Every

¹For an example see In Re Jon Beauforte (London) Ltd. (1953) 1 Ch. 131.

third party can now deal with the company in full confidence that the company has the powers and capacity of a natural person and they will not be deemed with notice which might undermine a transaction.

(2) If the Company imposes Restrictions on its Business Activities

As noted earlier, a company may impose limitations on its business activities. The question arises as to how constructive notice affects a third party dealing with the company which has imposed such restrictions. The issue which arises is the method in which the company will place its restrictions.

(a) By-laws

It is possible to incorporate these limitations in the company by-laws. Since the by-laws have not been considered 'public' documents and there is no registration requirement for them in the current Act, the doctrine of constructive notice will not apply. Thus, if a company enters into a transaction with a third party which exceeds its limitations, the third party will not be deemed to have notice of the restrictions.

(b) Fundamental change requiring a special resolution

If the restrictions that a company impose on itself are approved of by the company in the same way as are other fundamental changes--that is by special resolution, then s. 147 of the current Act comes into play:

147. (1) Where no express provision is made by this Act, a copy of every special resolution of a company, and of every ordinary resolution affecting the contents of the articles of a company, shall, within 15 days from the passing thereof, be filed with the Registrar.

(2) Every company that makes default in filing a copy of a resolution with the Registrar as required by this section is guilty of an offence.

[R.S.A. 1970, c. 60, s. 147]

This means, of course, that the restrictions will be 'public documents' and the doctrine of constructive notice must be considered. In this regard, the position taken by the Company Law Committee becomes important:²

The general feeling of the meeting seemed to be that the creditor or third party should not be affected in any way by any limitations of powers, even if they know about them.

Following this line of reasoning, the question of notice actually becomes irrelevant because whether or not the third party has notice, his contract with the company will be valid.

VI. RECOMMENDATIONS

In order to clear up any possible inconsistencies in the law as regards constructive notice, it is recommended that the new Act contain a section abolishing the doctrine. The

²Minutes of the Company Law Committee, June 18, 1975, page 1.

question of the scope of such a provision has been determined by the ultra vires recommendations. Thus, unlike the Dickerson report which recommended abolition of constructive notice "except where the person has or ought to have by virtue of his relationship to the corporation, knowledge to the contrary",³ in order to be consistent with the earlier decisions on ultra vires, constructive notice will have to be abolished against third parties in all situations excepting fraud or collusion, but including instances where the third party has or ought to have had knowledge of the restrictions.

It must be remembered that constructive notice affects more than just the object clause of a company's documentation. All the public documents of a company are subject to this rule. For the reasons noted in section IV, it is submitted that third parties should be freed from this onerous and expensive procedure which indeed has little practical value in modern corporate affairs. To quote the Dickerson Report:⁴

It may be that prudent people do inspect public documents in their own interests. That, however, is a far cry from imposing upon them as a matter of course a legal duty to do so--and that is the effect of the doctrine of constructive notice.

VII. SUGGESTED DRAFT LEGISLATION

The following are three ways in which the doctrine of constructive notice has been abolished in total (as was recommended in section V) in other jurisdictions:

³Dickerson, Proposals for a New Business Corporation Law, Vol. II, s. 305.

⁴Dickerson Report, Vol. 1, para. 84.

(1) Corporation Act - California s. 803

(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.

(2) The Dickerson Report - Draft Legislation (now s. 17 of the Federal Act)

3.04 No person is affected by or is deemed to have notice or knowledge of the contents of a document concerning a corporation by reason only that the document has been filed by the Registrar or is available for inspection at an office of the corporation.

(It should be noted that the Federal Act based on a later section of the Draft Legislation modifies the effect of the constructive notice doctrine by instructing the court to use an objective test so as to allow a company to assert knowledge requirements against a third party - see s. 3.05 of the Draft Legislation or s. 18 of the Act.)

(3) The British Columbia Companies Act, S.B.C. 1973

28. In any proceedings by or against a company, no person shall be affected by or shall be deemed to have notice or knowledge of the contents of a document or record concerning the company by reason only that the document or record has been filed with the Registrar or is available for inspection at an office of the company.

NOTE: There is no specific section in the Ontario Business Corporations Act dealing with constructive notice.