

## TRENDS IN THE CONCEPT OF ULTRA VIRES: THE NIGERIAN RETHINK

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**ABSTRACT:** *The concept of ultra vires which literarily means beyond legal capacity envisages that a company which becomes a legal personality by virtue of its incorporation cannot carry on business beyond the object contained in its Memorandum of Association. Any business so carried out by the company which is not within its object becomes ultra vires and thereby, invalid. This seeming concept as found statutory flavour under section 39 of the Company and Allies Matters Act, Cap C.20, Laws of the Federation of Nigeria, 2004 with modifications to reduce the hardship it hitherto melted against third parties. It is in this wise to argue that Companies haven become an accepted part of the economic landscape, thereby enabling legislation governing corporate practice began to authorize the general purpose clause, in any case giving companies virtually unlimited powers. This has made the ultra vires doctrine to have limited relevance in the realm of corporate governance. At about the turn of the last century, courts began to recognize the unfairness of the strict application of the ultra vires doctrine particularly in two major respects. Case laws, statutes, reported and unreported cases were arrived at in reaching some basic conclusions namely that, where one of the parties had already substantially performed, the defence of ultra vires only became available where the contract was still executory. Secondly, the purposes and powers clauses were interpreted more flexibly to authorize transaction reasonably incidental to the business. Does the continued retention of the ultra vires under the Nigerian law still make any corporate sense at the turn of the third millennium?*

**KEYWORDS:** Ultra vires, legal capacity, company law, jurisdiction, object clause.

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## INTRODUCTION

The constitutional framework for incorporated companies is based on the incorporation documents submitted at the time of registration. Section 35 (1) (a) of companies Allied Matter's Act 2004, requires that the constitutional documents be lodged with the corporative Affairs Commission in this way, essential components of the company's constitution, such as its name, address, object status limited or unlimited, private or public, and capital structure are published. Anyegbunam, reiterated the well-settled position laid down in *Guinness v Land Corporation of Ireland*,<sup>1</sup> that the articles of association are subordinate to the memorandum. That the articles cannot modify the memorandum and that if there is any inconsistency between the two, the terms of memorandum must prevail. The Chief Judge went on to state that there are some fundamental differences between the Memorandum and Articles of association. The Memorandum contains

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<sup>1</sup> (1983), 22C11D349

the fundamental conditions upon which the company is, allowed to be incorporated. They thus contain conditions for the protection of creditors the outside public and also for the regulations of the company.

It is generally thought that the conception of the company as a separate person in law, distinct from its shareholders, is directly associated with the basic legal doctrine that a company may not legally carry out any activity which is not expressly or impliedly authorized by statute or by the list of objects and powers in its memorandum. However, the Anglo-Nigerian doctrine of *ultra vires* is one that relates back to constitutional limitation. Nevertheless, it is quite clear that bounds are set on the legal competence of a company as a matter of statutory policy. The doctrine of *ultra vires* was related only to statutory corporations. It was never applied to registered companies because there was none within the period. The dominant form of business then was partnership and the *ultra vires* rule had no relevance to partnership because such transaction was rectifiable as lack of capacity was hardly applicable to partnership for its limited liability. Therefore, one had to wait until 1850 when the JSC.ACT was introduced which required every company to register its memorandum and article of association. The memorandum states the object of the company and from them on the *ultra vires* doctrine started gaining prominence. Thus any activities done in the company's name, and which exceeds its constitutional limitations were *ultra vires*, literally beyond its powers<sup>2</sup> in that the company's legal capacity is held to be limited by the Companies Act of 2004 and its own constitution.

### Statement of the Problem

*Ultra vires* could arise due to lack of capacity or owing to lack of authority. Lack of capacity arises in a situation where the company lacks the power on its own to act because it is outside its object clause. Lack of authority on the other hand relates to the officers of the company who act within the object of the company but without authority to do so. In both instances the act would be *ultra vires* but different legal consequences flow. Whereas in cases of lack of capacity such act cannot be ratified even unanimously by the members of the company. In cases of lack of authority, such act can be ratified. However, the two are treated together except where they have separate legal consequences.

The concept of the doctrine of *ultra vires* was mainly due to the court rather than to parliament. It was developed although not in its form today as far back as 1613, where it was held that a company could be restrained from exceeding the object stated in the charter of incorporation. In *Colman v Eastern Countries*,<sup>3</sup> an injunction was granted to restrain a company from going outside its charter on ground that it was *ultra vires*.

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<sup>2</sup> Ogbagbe, K.N, "Revisiting the Doctrine of Ultra Vires under CAMA,2004". *Nigerian Journal of Legal Studies*, Imos State university, Owerri, Nigeria, Volix,2010/2011, pp102-104. See also Orojo, J.O. *Company Law and Practice in Nigeria*, 5<sup>th</sup> Edition (South Africa: Lexis Nexis, 2008) pp98-99. Specifically see Agbonika, J.M.A, The Present State of the *Ultra vires* Doctrine Under the Nigerian Company Law: An Appraisal, *Commercial & Industrial Law Journal*, Dept. of Commercial & Industrial Law, Faculty of Law, Kogi State University, Anyigba, Vol3, No2, 2012-2013, pp188-189.

<sup>3</sup> (1847)12 BEAV 339

The situation remained in Nigeria prior to the enactment of section 39 of Company and Allied Matter Act 2004, where the courts were obliged to construe the object clause strictly in determining if any activity is within the *vires* of its objects.<sup>4</sup>

The leading case on the doctrine of *ultra vires* in Nigeria is *Continental Chemist Ltd v Ifeakandu*,<sup>5</sup> where the object of a company was the buying, selling, importation, exportation and manufacturing of drugs, and any other thing that would be profitable or incidental or conducive to the main objects. The court held that the object of the company did not include training of Doctors and that the object allowing the company to do anything profitable was indefinite and useless to be of assistance to the company and therefore the transaction was *ultra vires*.

This doctrine as we have same till date was fully developed in the case of *Asbury Railway Carriage & Iron Co. v. Roche*<sup>6</sup>, the principle of law enunciated in this case remained that that after a company is incorporated, the memorandum becomes the charter of its activities and the same time defines its field of operation. Apart from statutory powers, anything done outside the stated objects is *ultra-vires* the company; it is invalid and cannot be ratified by the member. Lord Cairns further stated said that the rule served the dual purpose of protecting both investors and creditors. But the rule is applied liberally so that whatever is fairly incidental to the objects stated in the memorandum unless expressly prohibited is regarded, as *intra vires*.<sup>7</sup>

### **The Business or Object of the Company**

The business or object of the company is the purposes for which it is formed. The statement of the business or objects determines the extent of the power conferred on the company. It assures the investors of precisely what their money is to be invested in as well as protecting outsiders who deal with the company by assuring them of the limits of the powers of the company since the power must be exercised in furtherance of the authorized business or object. Section 27 (1) (c) of the Companies and Allied Matters Act<sup>8</sup> requires the memorandum to state the nature of the business or businesses which the company is authorized to carry on, or if the company is not formed for the purpose of carrying on business, the object or objects for which it is established. Thus every company to be registered in Nigeria should contain a memorandum of the company.

The object clause states the objects of the company. The objects are derived from the purposes as conceived by the promoters. Thus every company after registration is required in doing its business to stick exclusively to its objects as stated in its objects clause. Any action taken by or on behalf of the company outside these objects is therefore absolutely void under the doctrine of *ultra vires*, it will be void *ab initio*, completely dead and of no legal effect whatsoever.

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<sup>4</sup> Cottrell. J. "Ultra Vires is Alive and Living in Nigeria" (1972)3 N.J. Contempt L.20.

<sup>5</sup> (1966) ALL NLR p.1 See also *Afolabi v Polymere Industries Ltd*(1975)LR71LL653

<sup>6</sup> (1875)LR7HL,656. See also *Standard Bank(Nig Ltd) v Bolokor Ent Ltd*,(1980)FRN,114

<sup>7</sup> See *Attorney General v Great Eastern Railway Co.* (1880)5 APP Cas 473

<sup>8</sup> (2004.)

**“MAIN OBJECT” RULE OF CONSTRUCTION**

Alarmed by the ultra vires doctrine’s operation, businessmen have therefore been engaged in a continuous fight with courts in an attempt to evade the doctrine. Their first attempt was to set out in the memorandum extremely wide, diverse and imprecise objects and powers covering every conceivable activity which the company might wish to undertake either immediately or at future time. The courts reacted by limiting the efficacy of such widely drawn objects clauses by the application of the “Main Object” rule.

**Definition**

The “Main Object” rule of construction is that where a memorandum of association expresses the objects of the company in a series of paragraphs and or one paragraph, or the first two or three paragraphs, would appear to embody the “main object” and as limited or controlled thereby.<sup>9</sup> A registered company has powers thereby to carry out the objects as set out in the memorandum and also everything which is reasonably necessary to enable it to carry out those objects. As Lord Selborne L.C. posited in *Attorney General v Great Eastern Railway*<sup>10</sup> that:

*The doctrine of ultra vires ought to be reasonable, and not unreasonably, understand and applied, and... Whether may fairly be regarded as incidental to or consequential upon, those things which the legislature has authorized, ought not (unless expressly prohibited) to be held, by judicial construction, to be ultra vires.*

For example, a company formed “to buy, and deal in coal” may, for the purposes of carrying out the stated objects, employ labour, open shops, buy and hire lorries, purchase, supplies, draw and accept bills of exchange, borrow and give security, and pay bonuses and pension to employees. In *Re: German Gate Coffee*<sup>11</sup> the ‘main Object’ of construction was applied. In *Re: Crown Bank*, North J. said that, if the memorandum were to state, as the objects of the company, that it was to carry on any business whatsoever which the company might think would be profitable to the shareholders, that in his opinion that would not be a statement of the objects of the company as required by the Act of parliament<sup>12</sup>.

In spite of the fact that both cases dealt with winding up, rather than an application of the ultra vires doctrine. It should however be noted that in each of these cases the company was wound up because its substratum, the main objects had disappeared because it had abandoned its objects. This simply meant that it was acting beyond its objects, same as acting *ultra vires* its object. This was indeed the approach followed in the Nigerian case of *Continental Chemist Ltd v Dr. C.A Ifeakandu*<sup>13</sup> where the Supreme Court held that “paragraph (c)” was indefinite and useless basing this ruling on the view expressed by North J. in *Crown Bank* namely that a sub- clause which stated that the company is to carry on any business whatsoever which the directors might think

<sup>9</sup> Solomon J. in *Agbki Overseas Ltd v Green* (1961) QB I at p.8

<sup>10</sup> (1880)IQB1ATP.8

<sup>11</sup> (1882)29Ch:D. 169 at p. 188

<sup>12</sup> (1890)44Ch,634

<sup>13</sup> (1960)1 N.L.R.I

profitable to the shareholders would not be a statement Of the objects as required by the Companies Act of 1968. In *Bell House ltd v City Wall Property Ltd*<sup>14</sup> Salmon L. J. said that North J. was mistaken on the ground that the registration of a company's memorandum is conclusive evidence that it complies with the companies Act 1968, therefore the courts are confined to the construction.

However, the main object rule of construction can be excluded by the appropriate provision in the memorandum. In most cases for example as the case of *Cotman v Brougham*<sup>15</sup> and *Anglo Overseas Ltd v Green*<sup>16</sup> a sub-clause provides, in effect, that each of the objects is to be regarded as a main object. It may be mentioned here that when the main object of a company fails for any reason, the substratum of the company is said to have gone and the company may be wound up as the "main Object" rule cannot be excluded. The reason is as Lord Parker of Waddington said in *Cotman v Brougham* that<sup>17</sup>the question whether or not a company can be wound up for failure of substratum is a question of equity between a company and a third party.

However, the company will not be wound up if the substratum has not gone. Further, a company can only be wound up on the ground that the substratum has gone on a shareholder's petition and no shareholder is obliged to petition to have the company wound up if he would prefer it to carry on some other business authorized by its memorandum.

### THE INDEPENDENT OBJECT CLAUSE

The rule that there is a "Main Objects" clause and all the others are ancillary to the "Main Objects" still lingers on. To exclude this rule draftsmen now incorporate provisions in the memorandum to effect that all objects or powers specified therein should be read separately and independently of the others as objects where there is such a provision, it will be given a legal recognition by the courts so that each of the objects will be given a legal recognition by the courts so that each of the objects will be treated as a main object quite distinct from others, for example in *Cotman v Brougham*<sup>18</sup>. The House of the Lords treated each of the sub clauses as a main object of the company. In this way it would appear that the businessmen have won the day. But this is not a total victory as shown by the decision of the Court of Appeal that one cannot have an object to do every mortal thing one wants, because that is to have no object at all. It was held further that a sub-clause, although specifically stipulated to be an independent object of the company can still be held to be subsidiary and ancillary to the main objects clauses if it falls into the category of sub-clause which relate to matters incapable of being read as independent objects in the sense that they authorize the company to undertake some activity as its "sole activity" of the company are to be treated as independent objects, if left alone will represent a senseless operation, thus restricting it to the legitimate activities of the company. Hence, it would appear that the law in England is more or less in line with that in Nigeria on this vexed problem.

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<sup>14</sup> (1966)22 W.L.R.. 1323 at p. 1342

<sup>15</sup> (1918) A.C. P.513

<sup>16</sup> (1961)1 QB I atp.8

<sup>17</sup> (Supra)

<sup>18</sup> (1918)C 514



## THE EFFECT OF ULTRA VIRES DOCTRINE ON THE COMPANY

The Ultra vires doctrine was designed to give protection to shareholders and creditors by confining the company to its stated object. One would therefore have thought that only the company could invoke the rule and that when a court declares a contract ultra vires the objects of the company, the idea should be to prevent expenditure of the company's funds on activities that have not been agreed to by the shareholders. But as the developments, have shown that this is not the effect of the ultra vires doctrine which operates not only against the interest of other parties but also that of the company. Thus the other party to the contract can invoke the ultra vires doctrine to escape from a transaction when he considers profitable to do so. For example, in the *Ifeakandu's Case*,<sup>19</sup> the Supreme Court of Nigeria accepted the defendant's plea of *ultra vires* without even saying a word on the impropriety on his part-getting away with his contractual obligation without reimbursing the company for the training he has had. A decision like this one would usually lead to unjust depletion of the company's assets.

It is therefore hoped that when next a similar case like *Ifeakandu's* case comes before the Nigeria Courts they would give a serious thought to the boomerang effect of the *ultra vires* doctrine with a view to making the rule more meaningful by holding that the third party cannot plead that the transaction is *ultra vires*.

## RIGHTS OF THE OTHER PARTY UNDER THE ULTRA VIRES DOCTRINE

It is trite that the ultra vires transaction cannot vest rights in the transferee or divest the transferor. The question therefore arises as to Whether the third party has any rights and remedies on an ultra vires transaction in which purported transfer of property are made. As for contracts that are executory. It is a simple matter as they cannot be enforced but the problem arises where the contract had been fully executed. The decisions handed down by the courts would seem to establish the following principles.

First, if money is lent to a company on an ultra vires borrowing and the company uses it or part of it to pay off legitimate indebtedness the lender is entitled to equity to rank as creditor to the extent which the money has been so applied. In other words he is subrogated to the right of the legitimate creditors who have been paid off.

Secondly, the lender in an ultra vires loan transaction has the right at common law and inequity to trace his money since the money has always been his own as the company cannot be a party to an *ultra vires* act,<sup>20</sup> even if the money is used to purchase a particular asset, he is entitled to recover the property purchased.<sup>21</sup>

Thirdly, the third party may have a personal claim against the directors or other agents of the company for restitution.

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<sup>19</sup> *Continental Chemists Ltd.v. Ifeakandu* (1960) 1 Aji ELR

<sup>20</sup> *Sinclair v. Brougham* (1914) AL. 398.

<sup>21</sup> (supra)

It is also possible that a lender can sue in deceit where the authority is willfully misstated or on a breach of implied warranty of authority. The problem here is that he will be confronted with the doctrine of constructive notice of the memorandum of association. It seems the directors will only be liable if the misrepresentation is that of fact rather than law.<sup>22</sup>

The above are the judicial attempts to mitigate the harshness of the ultra vires doctrine by making remedies available to the third party to recover his property.

### **THE DOCTRINE OF CONSTRUCTIVE NOTICE.**

A contract ultra vires a company is void and it has been said that the ultra vires contract cannot become intra vires by reason of estoppels, lapse of time, ratification, acquiescence, or delay.<sup>24</sup> Persons dealing with the company, even if they do not have actual notice of the company's powers because they have not inspected the memorandum, have constructive notice of the powers, i.e. they are deemed to know them, because the memorandum, like most of the documents registered with the Registrar of companies is open to public inspection and could have been inspected. Accordingly, if they make a contract which is to their knowledge, actual or constructive, ultra vires the company, and the company takes the point, they cannot enforce it. If they have supplied goods or performed services under such a contract they cannot obtain payment, and if they have lent money the general rule is that they cannot recover it.

Money or other property which can be traced into any particular asset of the company or the proceeds of sale of that asset can be claimed, because the company is deemed to hold it as a trustee for the person from whom it was obtained to share in the distribution of surplus assets after the creditors entitled to prove and winding costs have been provided for.

### **RIGHTS OF THE COMPANY UNDER *ULTRA VIRES* CONTRACTS.**

A company can recover its property which is still in the hands of a third party. The company also claims against the directors for breach of trust. But a company cannot recover its money or other property which it has spent or disposed of for an ultra vires purpose. But a director, who parts with the company's money or property for an ultra vires purpose will be liable to the company for the loss it has sustained, even if he acted in good faith, because the company itself cannot legally authorize him to do an *ultra vires* act. Accordingly, where an ultra vires issue of share has been made, and the company becomes solvent, the subscribers are entitled to recover their money.

### **CONCLUSION & RECOMMENDATIONS**

The question is whether or not the doctrine of ultra vires is worthy of retention in Nigeria? That the ultra vires doctrine has outlived its usefulness cannot, therefore as seen from merely as a wishful thought ravaged only in legal academic. The doctrine has been severely criticized by the Cohen Committee and Text Book writers. Cohen Committee reporting in England in 1945 arrived at the conclusion that in consequence the doctrine of Ultra Vires is an illusory protection

<sup>22</sup> *Chery v. Colonial Bank of Australia* (1869) L.R. 3 p. C. 24

<sup>24</sup> (1875) L.R.7 H.L.869 at p.893.

for the share-holders and yet may be a pitfall for third parties dealing with the Companies. The doctrine serves no positive purpose but is on the other hand, a cause unnecessary prolixity and vexation. The Committee, therefore, recommended that as regards third parties a Company should have all the powers of a natural person and that the memorandum should operate solely as a contract between a Company and its shareholders as to the powers exercisable by directors. The Cohen Committee's criticism is echoed by Professor Gower when he wrote that, it has ceased to be a protection to any one and has become merely a trap for the unwary third party and a misance to the Company itself having outlived its usefulness.

The Committee, on the other hand, has argued that the abolition of the Ultra Vires Doctrine would mean giving to the Company all the powers of a natural person as regards third parties. What this means in effect is that all the wide powers to be vested in the Company would be exercisable in their entirety by the director. The Committee, therefore, considered that this would be a retrograde step in view of the present desire that shareholders should be given greater and more effective control over the activities of directors. Accordingly they recommended that the Ultra Vires Doctrine should be retained but that actual knowledge of the contents of the memorandum and Articles should not deprive a third party of his right to enforce the contract if he "honestly and reasonably failed to appreciate that they had the effect of precluding the Company (or any director or other person on its behalf) from entering into the Contract in question. The committee also recommended that the constructive notice rule should be abolished.

While Gower's comments favourable on the Jenkin's Committee's recommendation that if implemented the sting would have been removed from the *Ultra Vires* Doctrine. Pennington, however, regards them as being quite unsatisfactory. He explained that instead of getting rid of the unnecessary complexities in the Law. The Jenkins Committee would allow them to contract against a Company." Pennington is therefore, of the opinion that the *ultra vires* doctrine should be completely abolished.

A more speedy way of achieving justice would be to abolish the *ultra vires* rule altogether as a ground for invalidating contracts and dispositions of property. It would then operate only within the Company, as between directors and shareholders, by enabling shareholders to restrain directors from entering into proposed *ultra vires* contracts. What is good for the goose is good for the gander. The writer like Agbonika,<sup>25</sup> proposes the good old days of the *ultra vires* doctrine must and should be dead and buried. Nigeria in the annals of the comity of nations should be abreast of its peculiarities and avoid the pit holes noticeable in other jurisdictions. A word is enough for the wise.

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<sup>25</sup> Agbonika op. cit at p181