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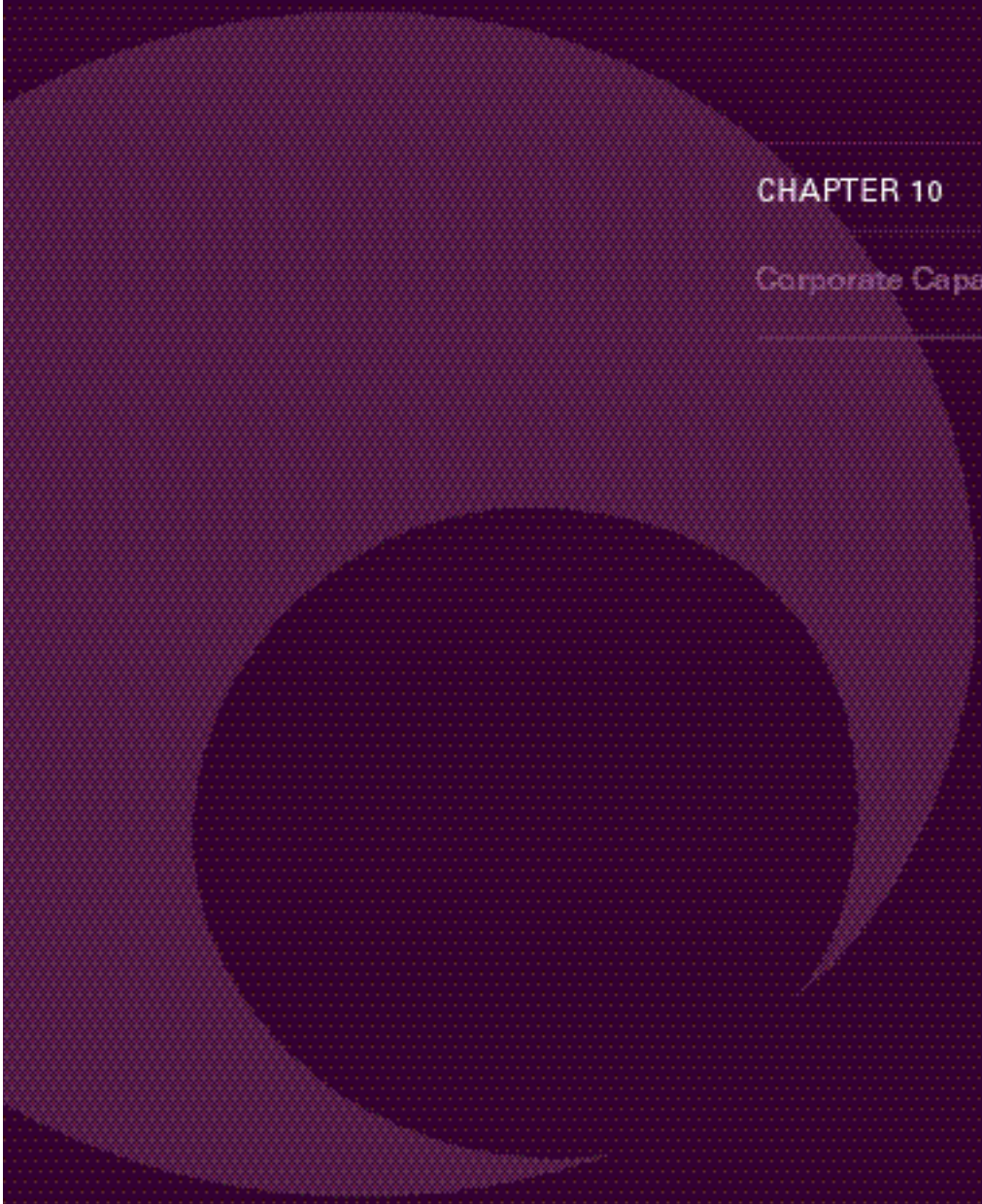
CHAPTER 10

Corporate Capacity and Authority



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10.1 Introduction

10.1.1 The Review Group was asked to consider whether the *ultra vires* doctrine, applicable today, should be retained or reformed. A transaction entered into by a company, which does not come within that company's objects (as described in its memorandum of association), or which is not reasonably incidental to its objects, is *ultra vires*. A contract, outside a company's objects, is void and unenforceable against the company (save in certain circumstances where the company's counterparty has entered contractual relations with the company in good faith).

10.1.2 The *ultra vires* doctrine, to a greater or lesser extent, has been diluted or removed in a number of common law jurisdictions. It is now associated with circumstances where the legitimate business expectations of parties to a transaction have been frustrated, with unjust consequences.

10.1.3 It appears from the case of *Sutton's Hospital* (decided nearly 400 years ago),[1] that a chartered corporation had all the powers of a natural person, but if it exceeded its objects as set out in its charter then action could be taken to restrain the corporation or to have its charter forfeited. This action though, if successful, would not affect the validity of the transactions entered into by the corporation.

10.1.4 With the development of industry and commerce (particularly in England) during the 19th century, the need arose to protect the interests of investors/shareholders and creditors to the effect that a corporation's activities be restricted to activities set out in its objects clause.This is subject to the corporation being able to carry on any activity incidental to the objects such as a trading company's powers to borrow.[2] This approach was firmly established, in 1875, in *Ashbury Railway Carriage and Iron Co. v. Riche*[3] where the House of Lords emphasised that the purpose of the *ultra vires* rule is the protection of both investors and creditors, i.e. investors should know the purpose for which their funds are to be used and creditors should know the nature of the business of the company to which they are giving credit.

10.1.5 Although the intention was that a company be limited in its activities by the objects set out in its memorandum of association, this has been effectively circumvented by companies having objects clauses enabling them to carry on most types of activity.[4] However, the courts have constrained this development by distinguishing between objects and powers, powers being used only for the purpose of carrying out the objects.[5]

1 (1612) 10 Co Rep 1.

2 *General Auction Estate and Monetary Company v. Smith* [1891] 3 Ch 342.

3 (1875) LR 7 HL 653. The rule was applied in Ireland as early as 1886 in *Re The Balgooley Distillery* (1886) 17 LR Ir 239 and later in *Re Bansha Woolen Mills Co Ltd* (1887) LR Ir 181. The *Ashbury* authority was expressly imported into post-1937 Irish law in *Re Cummins, Barton v. Bank of Ireland* [1939] IR 60 and in *Hennessy v. Agricultural and Industrial Development Association* [1947] IR 159. 4

4 In *Bell Houses Ltd v. City Wall Properties Ltd* [1966] 2 QB 656 the Court of Appeal upheld the validity of an object permitting the company to "carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or ancillary to any of the above businesses or the general business of the company."

5 The distinction was explained by *Buckley LJ in Re Horsley & Weight Ltd* [1982] Ch 442 at 448: " In the case of express 'objects' which, upon construction of the memorandum or by their very nature, are ancillary to the dominant or main objects of the company, an exercise of any such power can only be *intra vires* if it is in fact ancillary to the pursuit of some dominant object." In *Cotman v. Brougham* [1918] AC 514 the House of Lords mitigated the effects of the "main objects" rule by upholding an "independent objects clause" which declared that every sub-clause of the objects should be construed "as a substantive clause and not limited or restricted by reference to any other sub-clause…and none of the sub-clauses or objects specified therein should be deemed subsidiary or auxiliary merely to the objects mentioned in the first sub-clause." The limits of the independent objects clause were exposed, however, in *Re Introductions Ltd* (No 1)[1968] 2 All ER 1221 where it was held that the power to borrow money can never be an independent object.

10.2 UK analysis and reform

10.2.1 In 1945 the Cohen Report[6] in the UK noted the tendency to include a whole range of activities in a company's objects clause, the effect of which was to make the doctrine of *ultra vires* "an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company."[7] They considered that "the *ultra vires* doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation."[8] Accordingly, they recommended that a company have the same powers as an individual. However, this recommendation was not implemented in the UK Companies Act 1948.

10.2.2 Subsequently, in 1962, the Jenkins Committee[9] reported that a company, not being a natural person, could act only through directors or other agents exercising powers delegated to them by the company. The Committee considered that the delegation to the directors of all the powers of a natural person (conferred on the company) would be a retrograde step. The Jenkins Report highlighted the difficulty posed by third parties being fixed with constructive notice of the directors' delegated powers, which would make the third party fixed with such notice little better off if the *ultra vires* rule was abolished. The Report stated that "to give complete protection to the third party it would be necessary to absolve him not only from constructive, but also from express, notice of any limitation upon the directors' delegated powers. In other words he would have to be deemed not to know things which he actually did know – a legislative expedient which seems to us highly undesirable."[10]

10.2.3 The Jenkins Report did recommend that a contract should not be invalidated against a party entering into the contract "in good faith" even though the contract was beyond the powers of the corporation.[11] The concept of "good faith" was given statutory recognition in the UK by the European Communities Act 1972. Real reform seemed likely in the UK with the introduction of the Companies Bill 1973 but, with the change of government the following year, the Bill lapsed.

10.2.4 Some reform was made by the UK Companies Act 1985. Shortly thereafter, a report on the reform of *ultra vires* was prepared by Dr Dan Prentice of Pembroke College, Oxford, for the Department of Trade and Industry.[12] The consultation document which followed his report invited recommendations on the proposals that:

(i) a company should have the capacity to do any act whatsoever;
(ii) a third party dealing with a company should not be affected by the contents of a document merely because it is registered with the Registrar or with the company;
(iii) a company should be bound by the acts of its board or of an individual director;
(iv) a third party should be under no obligation to determine the scope of the authority of a company's board or an individual director or the contents of a company's memorandum or articles;
(v) a third party who has actual knowledge that a board or individual director does not have actual authority to enter into a transaction on behalf of the company should not be allowed to enforce it against the company but the company should be free to ratify it;
(vi) companies should not be required to register objects but should provide a statement of their principal business activities when they commence business and thereafter as part of their annual return;
(vii) no additional safeguards are required to protect the interests of shareholders and creditors against imprudent or unfair gratuitous distributions;
(viii) existing remedies are sufficient to protect the interests of shareholders generally even if full capacity is conferred on a company.[13]

6 Report of the Committee on Company Law Amendment (1945).
7 *ibid*., para 12.
8 *ibid*.
9 Report of the Company Law Committee (1963).
10 *ibid*., para 39(ix).
11 *ibid*., para 41.
12 *Reform of the Ultra Vires Rule, A Consultative Document*, Department of Trade and Industry (1986).
13 *ibid*., pp 3–4.

10.2.5 It appears to the Review Group that many of these proposals have much merit. These proposals gave rise ultimately to certain provisions of the UK Companies Act 1989. The Group understands that UK law (as set out in s 35 of the UK Companies Act 1985 and amended by s 108 of the UK Companies Act 1989) can be broken down into three sub-divisions:

(i) "the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum."[14] In addition, a member of a company may bring proceedings to restrain it from doing an act which would be beyond the company's capacity and it remains the duty of the directors to observe any limitations on their powers flowing from the company's memorandum;[15]

(ii) "in favour of a person dealing with a company in good faith, the powers of the board of directors to bind the company, or authorise others to do so, shall be deemed to be free of any limitation under the company's constitution."[16] A person is not regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution;[17]

(iii) "a party to a transaction with a company is not bound to enquire as to whether it is permitted by the company's memorandum or as to any limitation of the powers of the board of directors to bind the company or authorise others to do so."[18]

10.2.6 Subsequently, in October 1992, the final report of the Legal Risk Review Committee in the UK proposed that the *ultra vires* doctrine be abolished and all artificial persons should have the same capacity as natural persons. It indicated the reasons for this as being:

(i) "there is no conceptual reason why the powers of a corporation or other artificial person should be limited by its constituent instrument;

(ii) the powers or purposes expressed in that instrument may be treated as delimiting the powers of the corporation's agents to act on its behalf;

(iii) a counterparty dealing with the corporation may then be able to claim the benefit of the principle of ostensible authority;

(iv) this provides a general safe harbour for counterparties who reasonably rely on the corporation's representation that its agents have power to act on its behalf."

10.2.7 However, it added that it does not protect a counterparty who knew or should reasonably have known that the agent's powers were limited but removes risks arising from an honest misapprehension induced by the corporation itself.

10.2.8 The Review Group has sympathy with that Report's suggestion "that the *ultra vires* doctrine creates unnecessary risks and allocates them in an unfair way. It leads, as it did in the swaps case,[19] to a denial of legitimate expectations that bargains will be enforced." The Report concludes that some criticism can be made of the language of the amendments introduced by the Companies Act 1989 and it would in their view have been more elegant to adopt the Australian solution of giving a company the legal capacity of a natural person.

10.2.9 It appears that, notwithstanding the recommendations of the Legal Risk Review Committee, no action has been taken in the UK to implement the Committee's recommendations.

14 UK Companies Act 1985, s 35(1).
15 *ibid*., s 35 ss (2) & (3).
16 *ibid*., s 35A (1).
17 *ibid*., s 35A (2).
18 *ibid*., s 35B.
19 *Hazell v. Hammersmith & Fulham LBC* [1992] 2 AC 1; see 10.6.4 below.

10.3 Common law jurisdictions (outside the UK)

Australia

10.3.1 In Australia, the Corporations Act 2001[20] provides that "a company has the legal capacity and powers of an individual both in and outside this jurisdiction. A company also has all the powers of a body corporate…". It goes on to set out some powers.[21]

10.3.2 Interestingly, the legislation provides that "a company's legal capacity to do something is not affected by the fact that the company's interests are not, or would not be, served by doing it."[22] This provision should be particularly helpful in the context of corporate guarantees where a common law principle of commercial benefit has developed in Ireland,[23] a position more recently recognised by the 2001 Act.[24] It would be useful also in respect of some corporate transactions, such as a reorganisation, which may involve a gratuitous element on the part of a corporation within a group.[25]

10.3.3 The Australian legislation further provides[26] that "if a company has a constitution, it may contain an express restriction on, or a prohibition of, the company's exercise of any of its powers" and further that "if a company has a constitution, it may set out the company's objects." It goes on to provide that an act or the exercise of a power is not invalid merely because it is contrary to an express restriction or prohibition, or beyond any objects.

10.3.4 The legislation prescribes[27] the manner in which a person dealing with a company or its agent should act. It specifies that a person dealing with a company is entitled to make certain assumptions, namely:

> "(1) A person may assume that the company's constitution (if any), and any provisions of this Law that apply to the company as replaceable rules, have been complied with.
>
> (2) A person may assume that anyone who appears, from information provided by the company that is available to the public from ASIC[28], to be a director or a company secretary of the company:
>
> (a) has been duly appointed; and
> (b) has authority to exercise the powers and perform the duties customarily exercised or performed by a director or company secretary of a similar company.
>
> (3) A person may assume that anyone who is held out by the company to be an officer or agent of the company:
>
> (a) has been duly appointed; and
> (b) has authority to exercise the powers and perform the duties customarily exercised or performed by that kind of officer or agent of a similar company."

20 In s 124(1).

21 The powers listed in s 124(1) are: "(a) the power to issue and cancel shares in the company;(b) issue debentures (despite any rule of law or equity to the contrary, this power includes a power to issue debentures that are irredeemable, redeemable only if a contingency, however remote, occurs, or redeemable only at the end of a period, however long); (c) grant options over unissued shares in the company; (d) distribute any of the company's property among the members, in kind or otherwise; (e) give security by charging uncalled capital; (f) grant a floating charge over the company's property; (g) arrange for the company to be registered or recognised as a body corporate in any place outside this jurisdiction; (h) do anything that it is authorised to do by any other law (including a law of a foreign country)."

22 In s 124(2).

23 In *Hutton v. West Cork Railway Co* (1883) 23 Ch D 654 Hutton LJ stated that "charity cannot sit at the boardroom table …There can be no cakes and ale except for the benefit of the company," or as Murphy J put it in *Re Kill Inn Motel Ltd*, High Court, 16 September 1987, "a commercial body cannot make gifts." Accordingly, a trading company cannot: make gratuitous payments (*Parke v. Daily News Ltd* [1962] Ch 927); distribute surplus assets in a liquidation to persons who are not members (*Roper v. Ward* [1981] ILRM 408); nor guarantee the obligations of others (*Re PMPA Garage (Longmile) Ltd* (*No 1*) [1992] 1 IR 315) unless some benefit can be shown to accrue to the company as a result.

24 See s 78 of the 2001 Act which repealed and substituted s 34 of the 1990 Act.

25 In *Re Frederick Inns Ltd* [1991] ILRM 582 (High Court), [1994] 1 ILRM 387 (Supreme Court) the sale of assets by companies in a group with a view to meeting the liabilities of the group to the Revenue Commissioners was held to be *ultra vires* since the proceeds contributed by some of the companies exceeded their own individual liability to the Revenue Commissioners.

26 Corporations Act 2001.

27 *ibid*., ss 128 and 129.

The Review Group believes these assumptions are helpful.

10.3.5 However, the legislation provides that a person is not entitled to make such an assumption if, "at the time of the dealings they knew or suspected that the assumption was incorrect."[29] The Review Group believes this would give rise to interpretative difficulties, but may be useful with an additional statutory provision to the effect that there is no duty on a third party to review a company's constitution prior to entering into a contract with the company.

10.3.6 With regard to constructive notice, the legislation provides that (save in the case of a charge that is registrable under the Act) "a person is not taken to have information about a company merely because the information is available to the public from ASIC."[30]

New Zealand

10.3.7 There are somewhat similar provisions in the New Zealand Companies Act 1993 which provides that (subject to the other provisions of the Act) "a company has full capacity to carry on or undertake any business or activity, do any act, or enter into any transaction, and for [these purposes has] full rights, powers and privileges."[31] It provides also that subject to certain exceptions "no act of a company and no transfer of property to or by a company is invalid merely because the company did not have the capacity, the right, or the power to do the act or to transfer or take a transfer of the property."[32] It further provides, as in Australia, that "the fact that an act is not, or would not be, in the best interests of a company does not affect the capacity of the company to do the act."[33]

10.3.8 Helpfully, the New Zealand legislation refers also to guarantors. A company, or a guarantor of an obligation of a company, may not assert against a person dealing with the company, or with a person who has acquired property, rights, or interests from the company, that the constitution of the company has not been complied with; or that a person held out by the company as a director of the company has not been duly appointed, or does not have the authority to exercise a power "unless the person has, or ought to have, by virtue of his or her position with or relationship to the company, knowledge of the matters referred to."[34]

10.3.9 It is also provided that "a person is not affected by, or deemed to have notice or knowledge of the contents of, the constitution of, or any other document relating to, a company merely because – (a) the constitution or document is registered on the New Zealand register; or (b) it is available for inspection at an office of the company."[35]

10.3.10 The Review Group believes this is a useful provision, taking the objects clause out of the realm of being subject to constructive notice, although the Group believes it should be subject to the *caveat* that this does not apply to registered charges (as excluded under the Australian legislation).[36] Registered charges are a separate area of the law and not the subject of deliberation at this time by the Review Group.

Canada

10.3.11 The provisions under the Canada Business Corporations Act are somewhat similar; this Act[37] provides that a corporation has the capacity and rights, powers and privileges of a natural person.[38] Indeed, the New Zealand

28 Australian Securities and Investments Commission.
29 *ibid*., s 128(4).
30 *ibid*., s 130.
31 New Zealand Companies Act 1993, s 16.
32 *ibid*., s 17(1).
33 *ibid*., s 17(3).
34 *ibid*., s 18.
35 *ibid*., s 19.
36 See 10.3.6 above.
37 R.S. 1985, c-44.
38 *ibid*., s 15(1).

provision is almost identical to it. Although a corporation is restricted from exercising any power contrary to its articles[39] there is no constructive notice by virtue of a document being filed or available for inspection.[40]

Singapore and Malaysia

10.3.12 The Singapore Companies Act[41] and the Malaysian Companies Act[42] both provide that no act or purported act of a company shall be invalid by reason only of the fact that the company was without capacity or power to do such act.

10.3.13 In May 2000, the Registry of Companies in Malaysia issued a requirement that no more than three objects could be stated in a company's memorandum of association. In Ireland, the Registrar could not issue such a requirement without statutory authority. It could not be effective, in any event, without further reform as most companies carry out more than three objects or powers in the normal course of their business. It does, however, highlight the need for reform in common law jurisdictions.

10.4 The Cox Report and the 1963 Act

10.4.1 In 1958, the Cox Report[43] in Ireland noted that "the purpose of the doctrine of *ultra vires* has been largely defeated. It does not now give any protection to the shareholders or the creditors of the company and becomes a waste of time and paper. There is much in favour of the view that the doctrine should now be wholly abolished and that every company should have the same powers as an individual whether these are conferred by the Memorandum or not."[44] Despite this statement, the Committee decided not to recommend the abolition of the doctrine. In referring to the Cohen Report's recommendation for reform, they noted that this "is not adopted by the British Parliament and we must assume that there were strong reasons for this decision."[45]

10.4.2 However, partial reform was implemented by s 8 of the 1963 Act. This section states:

> (1) Any act or thing done by a company which if the company had been empowered to do the same would have been lawfully and effectively done, shall, notwithstanding that the company had no power to do such act or thing, be effective in favour of any person relying on such act or thing who is not shown to have been actually aware, at the time when he so relied thereon, that such act or thing was not within the powers of the company, but any director or officer of the company who was responsible for the doing by the company of such act or thing shall be liable to the company for any loss or damage suffered by the company in consequence thereof..
> (2) The court may, on the application of any member or holder of debentures of a company, restrain such company from doing any act or thing which the company has no power to do.

Accordingly, this section gives effect to any act done by a company, notwithstanding that the company had no power to do such act, in favour of a person who is not shown to have been actually aware, at the time when he so relied thereon, that such act or thing was not within the powers of the company.

39 *ibid*., s 16(2).
40 *ibid*., s 17.
41 Chapter 50; section 25(1) provides as follows: "No act or purported act of a company (including the entering into of an agreement by the company and including any act done on behalf of a company by an officer or agent of the company under any purported authority, whether express or implied, of 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."
42 Act Number 125 (1965).
43 Report of the Company Law Reform Committee (PR 4523) (1958).
44 *ibid*., p 20, para 49.
45 *ibid*., p 21, para 50. In fact the Cohen Committee's proposals had not been implemented simply because the Board of Trade decided it would not be justified in holding up the preparation of the UK Companies Act 1948 in order to work out what appeared to them to be a "far-reaching change" which could involve "highly complicated drafting."

10.4.3 Despite this reform, the practice of reviewing objects clauses to ensure that a company has the appropriate object or power to carry out and be bound by the intended transaction is still maintained in corporate, conveyancing and secured lending transactions. Notwithstanding the language of the statute – "actually aware" – the High Court held[46] that a person or its agent who has read the memorandum of association, but who has not understood the language to mean that the company lacked capacity to enter into a certain type of contract, is deemed still to have been "actually aware" of the company's incapacity and therefore cannot rely upon s 8. Thus, the reform implemented by s 8 has not resulted in any change in practice from that prevailing prior to the section's implementation.

10.4.4 More recently, the Supreme Court held that payments received by the Revenue Commissioners from a company in respect of taxes owed to them by other companies in the same group were *ultra vires*. Furthermore, although the Revenue Commissioners were not found by the Supreme Court to have been "actually aware" that the payments were *ultra vires*, they were prevented from relying on s 8 as the payments were held not to have been "lawfully and effectively done" within the meaning of s 8.[47]

10.5 The First Company Law Directive and the 1973 Regulations

10.5.1 Article 9 of the First Directive on Company Law[48] provides:

> 1. Acts done by the organs of the company shall be binding upon it even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs.
>
> However, Member States may provide that the company shall not be bound where such acts are outside the objects of the company, if it proves that the third party knew that the act was outside those objects or could not in view of the circumstances have been unaware of it; disclosure of the statutes shall not of itself be sufficient proof thereof.
>
> 2. The limits on the powers of the organs of the company, arising under the statutes or from a decision of the competent organs, may never be relied on as against third parties, even if they have been disclosed.
>
> 3. If the national law provides that authority to represent a company may, in derogation from the legal rules governing the subject, be conferred by the statutes on a single person or on several persons acting jointly, that law may provide that such a person in the statutes may be relied on as against third parties on condition that it relates to the general power of representation; the question whether such a provision in the statutes can be relied on as against third parties shall be governed by Article 3.

10.5.2 It further provides, in Article 11, that nullity may be ordered where the objects of a company are unlawful or contrary to public policy.

10.5.3 Accordingly, the First Directive encourages Member States to enable companies to be bound by actions and contracts entered into by their officers where such officers are carrying out their duties in accordance with the Companies Acts. This applies even where such officers carry on activities or enter into contracts in the name of the company and the company does not have the capacity to carry out such activities or enter into such contracts.

10.5.4 The Directive also enables Member States to provide that a company will not be bound by an *ultra vires* transaction if the third party knew of the incapacity or could not in view of the circumstances have been unaware of it. This aspect gives rise to difficulty as is evident from the uncertainty created by the Irish Regulations implementing this Directive and the concept of "good faith."

46 *Northern Bank Finance Corporation Limited v. Quinn & Achates Investment Company* [1979] ILRM 221.

47 In *Re Frederick Inns Limited* [1994] 1 ILRM 387; see also Lardner J in the High Court [1991] ILRM 582 at 590.

48 68/151/EEC of 9 March 1968 (OJ Special Edition 1968(1), pp 41–45).

10.5.5 The First Directive was implemented in Ireland by the European Communities (Companies) Regulations 1973.[49] Regulation 6 of these Regulations provides:

> (1) In favour of a person dealing with a company in good faith, any transaction entered into by any organ of the company, being its board of directors or any person registered under these regulations as a person authorised to bind the company shall be deemed to be within the capacity of the company and any limitation of the powers of that board or person, whether imposed by the memorandum and articles of association or otherwise, may not be relied upon as against any person so dealing with the company.
> (2) Any such person shall be presumed to have acted in good faith unless the contrary is proved.
> (3) For the purpose of this Regulation, the registration of a person authorised to bind the company shall be effected by delivering to the Registrar a notice giving the name and description of the person concerned.

10.5.6 These Regulations apply to every company with limited liability but not to companies with unlimited liability[50] (and thus they did not apply to the facts in the decision of *Northern Bank Finance Corporation Limited v. Quinn & Achates Investment Company*[51]).

10.5.7 The critical words of Regulation 6 are its opening words, namely "[i]n favour of a person dealing with a company in good faith." This is a very different test to that of s 8 of the 1963 Act as highlighted in the Second Report of the Joint Committee on the Secondary Legislation of the European Communities (1974). The words "good faith" have been considered outside the State in *International Sales and Agencies Limited and others v. Marcus and another*[52] and in *International Factors (NI) Limited v. Streeve Construction Limited*.[53] In the former case it was held that, "the test of lack of good faith in somebody entering into obligations with a company will be found either in proof of his actual knowledge that the transaction was *ultra vires* the company or where it can be shown that such a person could not in view of all the circumstances, have been unaware that he was party to a transaction *ultra vires*." In the latter case it was held that "the test of lack of good faith depends upon proof of actual knowledge that the transaction was *ultra vires* of the company or that the person dealing with the company could not have been unaware that he was a party to a transaction *ultra vires*, which amounts to a deliberate closing of one's mind to circumstances which would have pointed towards the conclusion of *ultra vires*."

10.5.8 The Review Group recognises that a difficulty with "good faith" is that it is a subjective test. A person cannot be sure he will be found to have acted in good faith unless the simple precaution is taken of ascertaining the capacity of a company and the delegated power of the persons with whom he is dealing prior to concluding a contract. For example, is a person acting in "good faith" if, when proposing to acquire a significant asset from a company, he does not examine the memorandum and articles of association to verify the powers of the company and those of its directors? At present, it would be surprising if the courts found the purchaser to be acting in "good faith" in choosing not to examine the company's memorandum and articles of association.

10.6 Current practice in Ireland

10.6.1 Notwithstanding the provisions of s 8 and Regulation 6, the practice (in transactions involving a significant sum of money) is still to review the objects clause and articles of association of companies entering into transactions. For example, a typical secured financing transaction may involve a company (in a group of companies) borrowing funds from a lender (or syndicate of lenders) to purchase a property and where each company in the group is guaranteeing the borrowing company's obligations to the lender and creating a mortgage and charge over their respective assets in support of their guarantees or, in the case of the borrowing company, to secure directly their own borrowings. Prior to finalising such a contract, the practice is that each company's memorandum and articles of association is reviewed to ascertain:

49 SI No 163 of 1973.
50 *ibid.*, Regulation 3.
51 See 10.4.3 above.
52 [1982] 3 All ER 551.
53 [1984] NI 245.

(i) its correct name;
(ii) its principal objects (to ensure that its borrowing is for the purpose of carrying out one or more of its principal objects);
(iii) its power to borrow and to mortgage/charge to secure borrowings;
(iv) its power to guarantee and to mortgage/charge to secure guarantees;
(v) the power of its directors to manage the company and thus to authorise the giving of a guarantee and a mortgage or charge;
(vi) whether the proceedings of its directors satisfy requirements as to quorum;
(vii) its directors' borrowing powers and any restrictions;
(viii) whether the company's sealing requirements in executing the mortgage/charge have been complied with; and
(ix) whether any other clause or article imposes a restriction on the execution and performance of the anticipated transaction (such as ministerial consent for semi-State companies or the consent of preference shareholders or debentureholders).

10.6.2 If there are any inadequacies, a special resolution will need to be passed by each company (having any inadequacies) amending its objects clause and/or articles of association so that the appropriate objects/powers/articles are sufficient. A notice of the resolution with an amended memorandum and articles of association must be filed in the CRO. A certified copy of the amended memorandum and articles of association is then provided to the lender's solicitor so that he may be satisfied as to the appropriate capacity and powers of the company. This procedure, as required by current law, clearly adds to the cost and time of completing a commercial transaction and, as such, the Review Group believes that it is detrimental to commercial enterprise.

10.6.3 Sometimes comfort is given to counterparties when a company represents and warrants in an agreement that it has the appropriate capacity and power to enter into the agreement to perform its obligations under and to be bound by the terms of the agreements. It may be thought that the company would then be estopped from denying its lack of capacity or powers. This is likely to be false comfort, for a liquidator of the company is unlikely to be bound by such a warranty or representation, particularly where the company may not have had the capacity to make such a warranty or representation in the first place.

10.6.4 The decisions in England at the end of the 1980s concerning the powers of local authorities to enter into interest rate exchange transactions, starting with the House of Lords' decision in *Hazell v. Hammersmith & Fulham LBC*,[54] prompted the Irish Bankers Federation to recommend to their members that they ensure that their corporate customers entering into interest and currency exchange agreements and other derivative transactions have the appropriate power to do so.

10.7 PLCs – The Second Directive on Company Law

10.7.1 The Second Directive on Company Law[55] sets out safeguards for the protection of the interests of members and others in respect of the formation of public limited companies. While the Directive was concerned principally with the maintenance and alteration of capital, it provided also that the instrument of incorporation of a public company limited by shares (and also a public company limited by guarantee and having a share capital), would include the objects of the company.[56] The Directive provides also that in so far as they are not legally determined, the instrument of incorporation would include the rules governing the number of, and the procedure for, appointing members of the bodies responsible for representing the company with regard to third parties, administration, management, supervision or control of the company and the allocation of powers among those bodies.

54 [1992] 2 AC 1.
55 77/91/EEC of 13 December 1976 (20 OJ L 26, 31 January 1977, pp 1 – 13).
56 *ibid*., Article 2: "The statutes or the instrument of incorporation of the company shall always give at least the following information: (a) the type and name of the company; (b) the objects of the company …".

10.8 Reform for State sponsored bodies

10.8.1 Due to the concerns raised by the English decision in *Hazell v. Hammersmith and Fulham LBC*[57] and questions raised as to the nature of finance leases and note issues (amongst others), partial reform has been implemented for State sponsored bodies. The Financial Transactions of Certain Companies and Other Bodies Act 1992 and the Borrowing Powers of Certain Bodies Act 1996 have removed uncertainty in certain specific areas of capacity for State sponsored bodies.

10.9 Objects and powers

10.9.1 The Review Group accepts that the ability of companies to provide for a multiplicity of objects and powers has rendered the rationale of the *ultra vires* doctrine obsolete in the 21st century. The Group believes that for contracts of a small monetary value the doctrine has become irrelevant as it is simply ignored. For contracts of a large monetary value the possible adverse consequences for a counterparty and its lawyer, in the absence of a thorough review of a company's constitution, are a very real factor. Each review of a company's constitutional documents utilises a lawyer's time at the cost of industry with no particular benefit to any person.

Private companies limited by shares (CLS)

10.9.2 Almost nine out of ten companies registered are private companies limited by shares.[58] The majority of these companies are closely held companies. In many instances the directors and shareholders are likely to be the same people or closely connected. Accordingly (apart from special types of companies such as special purpose companies[59] and property management companies[60]) the Review Group believes that private limited companies should not be required to set out any objects or powers; such companies should be empowered with the capacity of a natural person (without the natural person's incapacity status imposed by being a minor, insane, drunk or being subject to undue influence). Thus, the Review Group recommends that, except where otherwise specifically required by a company's promoters, private companies limited by shares be given the legal capacity of a natural person. Clause 2 of a company's memorandum of association should provide simply that pursuant to the relevant section in the proposed Companies Act the company has the legal capacity of a natural person.

10.9.3 The Review Group makes its recommendations for the repeal of the *ultra vires* doctrine for private companies limited by shares because:

(i) *ultra vires* offers little if any protection to shareholders; *ultra vires* has operated to the detriment of creditors;
(ii) *ultra vires* entails additional work to be undertaken by persons and their agents in the preparation of a company's constitution prior to its incorporation, as well as additional work by the CRO prior to the company being granted a separate legal status;
(iii) *ultra vires* results in additional delay and costs being incurred by purchasers, borrowers, guarantors (and other parties) in completing their business transactions;
(iv) *ultra vires* has resulted in some persons, who have entered into commercial arrangements in good faith, having their legitimate expectations thwarted;
(v) *ultra vires* has resulted in companies having pages of objects (and powers) so that they can carry out virtually any (non-regulated) activity thereby rendering the rule meaningless.

57 [1992] 2 AC 1.
59 Companies Report 2000; see 3.2.2.
59 See 10.9.10 below.
60 See 10.9.9 below

10.9.4 If the abolition of the doctrine of *ultra vires* for private companies limited by shares (other than special categories) is to mean anything in practice, it must be clear in any statutory reform that persons entering into contracts with such companies will receive the full benefit of the abolition, without the requirement or desirability for the company's counterparty, or his lawyer, to examine and consider the company's memorandum of association.

10.9.5 Under the current law, counterparties, particularly persons receiving guarantees, are or should be concerned that the guarantor company receives a benefit in giving the guarantee – a separate concept to the doctrine of consideration in the law of contract (which will continue to be relevant).

10.9.6 A gratuitous payment by a company, not specifically authorised by its objects, is *ultra vires*. The abolition of the *ultra vires* doctrine for private companies limited by shares may in the first instance appear to create the opportunity for companies to give gratuitous payments without restriction.[61] To restrict the ability to make such payments would negate the reform of *ultra vires* as it would require a counterparty or its lawyer to make enquiries as to certain payments and guarantees.[62]

10.9.7 It is for the shareholders to appoint persons as directors who will carry out their duties for the benefit of the company. The directors in carrying out their functions should ensure, for their own benefit, that they carry out their duties in accordance with their duties under the Companies Acts[63] and the powers delegated to them by the shareholders. A failure to do so may result in a successful action against them for breach of their fiduciary duty to the company or, indeed, for misfeasance.[64]

10.9.8 However, as already noted,[65] the Second Directive requires PLCs to have objects. There may, particularly in the case of companies which have a listing on an exchange, be some rationale for retaining objects so that investors can feel some comfort when acquiring shares in such a company. Public companies should thus continue to be subject to the *ultra vires* doctrine.

Companies limited by guarantee

10.9.9 The Review Group accepts that public policy considerations require certain companies to have objects. A company limited by guarantee and not having a share capital may be used also as a management company in residential apartment schemes. It is suggested that the members of such companies would wish their companies to have very specific and restrictive objects and powers. Similarly, companies whose functions are to carry out activities of a charitable nature, and which may be granted charitable status by the Revenue Commissioners, may require the retention of designated objects. Accordingly, the Review Group recommends that the *ultra vires* doctrine should be retained for companies limited by guarantee.

Special purpose companies

10.9.10 Individuals or corporations often form what are described as "special purpose companies" or "special purpose vehicles." As the name suggests, these are companies incorporated for a special purpose such as a joint venture or a financing company used in a single specific financing transaction. Many of these entities are used in transactions concluded in the International Financial Services Centre and are a recognised mechanism for achieving the legitimate expectations of the parties involved. It is considered by the company's promoters, in many such cases, to be essential that such companies are not empowered to enter into other transactions. Accordingly, the Review Group recommends that the doctrine of *ultra vires* be retained for special purpose companies.

61 But see the restrictions under s 51 of the 1983 Act on the making of distributions.
62 See also the Prentice Report's penultimate recommendation at 10.2.4 above.
63 For directors' duties proposed to be codified into the Companies Acts, see further Chapter 11.
64 For creditor protection, see further Chapter 5.
65 See 10.7.1 above.

Identity and transition period

10.9.11 To identify to a third party that a company has specific objects, and is therefore subject to the *ultra vires* rule, for a public limited company the word "plc" or for any other special category company, including companies limited by guarantee the word "dac" (standing for designated activity company) should form the last part of the name of such company.

10.9.12 A transition period of 12 months should be allowed for (non-public) companies wishing to retain objects to pass a special resolution to change their name (with the addition of "dac" to their name). No filing fee should be required for notifying the CRO of such special resolutions. A subvention should be provided by the State to the CRO to make up for the shortfall in such filing fees.

10.9.13 To avail of the *ultra vires* rule for its own benefit or the benefit of certain creditors over other creditors, a private company (being a company limited by guarantee and having a share capital or a special purpose company) should be required to change its name within 12 months to identify it as a designated activity company. Failure to do so at the expiration of 12 months should have the automatic effect of removing the company's objects and giving it the capacity of a natural person.

10.10 Authority to conclude transactions on behalf of companies

10.10.1 Even if a company is given the status of a natural person, a company nevertheless will, apart from certain contracts executed by it under its seal, require an individual to negotiate and conclude contracts on its behalf. Thus, notwithstanding the abolition of the *ultra vires* doctrine, there still remains the question as to whether the company should be bound by acts or contracts entered into on its behalf by any director or other person with purported authority.

10.10.2 Most companies adopt, as part of their articles of association, Regulation 80 of Part I of Table A of the First Schedule to the 1963 Act. This regulation provides:

> The business of the company shall be managed by the directors, who… may exercise all such powers of the Company as are not by [the Companies Acts] or by these regulations, required to be exercised by the company in general meeting…

Regulation 105 provides that the directors may delegate any of their powers to committees. Regulation 112 provides that:

> the directors may entrust to and confer upon a managing director any of the powers exercisable by them upon such terms and conditions and with such restrictions as they may think fit…

Regulation 6 of the European Communities (Companies) Regulations 1973[66] gives protection to a counterparty who has dealt, in good faith, with a company's board of directors or registered agent. To obtain the protection the counterparty has to show that he entered into the transaction with the board of directors (i.e. with their approval) or with a person registered under the regulations with the CRO as authorised to bind the company.[67]

10.10.3 The rule in *Turquand's case*[68] has also proved to be helpful to counterparties when entering into transactions, in good faith, with companies.[69] The rule does not require the counterparty to investigate whether the company has complied with its articles of association when entering into a transaction.

66 SI No 163 of 1973, see 10.5.5 above in connection with capacity rather than authority.

67 See Blayney J in *Re Frederick Inns Limited* [1994] 1 ILRM 387 at 394.

68 *The Royal British Bank v. Turquand* (1856) 6 El & Bl. 327.

69 See *Ulster Investment Bank Limited v. Euro Estates Limited and Drumkill Limited* [1982] ILRM 57.

10.10.4 In practice the concept of ostensible authority is used to negotiate and complete many transactions.[70] Examples of situations where the law of ostensible authority is relied upon include those where contracts are concluded by shop assistants, car salesmen, travel consultants and hotel reservation staff.

10.10.5 The Review Group believes a counterparty should be able to enter into contracts with a company without fear of invalidity due to lack of authorisation provided the counterparty does so with: (a) an agent of the company registered in the CRO as authorised to carry out the type of transaction in question; or (b) any other person who has actual or ostensible authority to bind the company. Whilst certainty for counterparties would be furthered by deeming contracts concluded with any director to be binding on the company, the Group concluded that this was not desirable, would be open to abuse and would be unjust to companies.

10.10.6 A search in the CRO, which can be done on the website,[71] through law researchers or in person at nominal cost, enables the names of registered agents to be ascertained. The Review Group believes that companies should utilise to a greater extent the facility of the CRO to register persons authorised to bind the company, as happens more frequently in other EU jurisdictions. Accordingly, the Review Group recommends that a person registered in the CRO should have authority to bind the company to lawful contracts concluded (on behalf of the company) within the terms of this authority as filed in the CRO without the need for counterparties to enquire further.[72]

10.10.7 Where companies adopt Regulation 115 of Table A, two directors or one director and the secretary are required to attest the company seal. The Review Group recommends that, as an alternative to this, where a registered agent is appointed and registered in the CRO he should be deemed to have authority to affix the company seal and to be the sole signatory to the seal, without the need for further enquiry on the part of counterparties.

10.10.8 Turning next to other persons authorised to bind the company, the best evidence that a particular person has authority is a resolution of the board of directors to that effect. In the absence of such evidence, it will be a matter of fact whether or not a particular director or other individual has actual authority to bind a company to a particular course of action. However, even if such a person does not have *actual authority*, companies may be bound to contracts where the person who concluded them has *ostensible authority*. The Review Group does not recommend any change in the law in this regard.

70 For further elucidation on this topic see the Supreme Court's decision in *Kett v. Shannon & English* [1987] ILRM 364.

71 This service is not currently available due to a court injunction.

72 See also 4.3.8.

tensummary

10.11 Summary of Recommendations

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- Private companies limited by shares (i.e. the proposed CLS) should be granted the legal capacity of a natural person with the consequent effect that the doctrine of *ultra vires* is disapplied from the CLS. **(10.9.2)**

- Public companies should be required to continue to have an objects clause in line with the Second Directive, and should thus continue to be subject to the *ultra vires* doctrine. **(10.9.8)**

- Companies limited by guarantee should be required to retain objects and continue to be subject to the *ultra vires* doctrine. **(10.9.9)**

- Special purpose companies, whether private companies limited by shares or otherwise, should be permitted to retain objects and be bound by the *ultra vires* doctrine. **(10.9.10)**

- Companies having objects, and thus subject to the *ultra vires* doctrine, should be identified with the words "plc" (where such companies are a public limited company) or "dac" as part of their name. **(10.9.11)**

- A transition period of 12 months should be allowed for (non-public) companies wishing to retain objects to pass a special resolution to change their name (with the addition of "dac" to their name). No filing fee should be required for notifying the CRO of such special resolutions. A subvention should be provided by the State to the CRO to make up for the shortfall in such filing fees. **(10.9.12)**

- To avail of the *ultra vires* rule for its own benefit or the benefit of certain creditors over other creditors, a private company (being a company limited by guarantee or a special purpose company) should be required to change its name within 12 months to identify it as a designated activity company. Failure to do so at the expiration of 12 months should have the automatic effect of removing the company's objects and giving it the capacity of a natural person. **(10.9.13)**

- An agent registered in the CRO should have authority to bind the company to lawful contracts concluded (on behalf of the company) within the terms of this authority as filed in the CRO without the need for counterparties to enquire further. **(10.10.6)**

- In addition to the provisions of Regulation 115 of Table A, where a registered agent is appointed and registered in the CRO he should be deemed to have authority to affix the company seal and to be the sole signatory to the seal, without the need for further enquiry on the part of counterparties. **(10.10.7)**