OBJECTS AND POWERS IN COMPANY LAW

*In re HORSLEY & WEIGHT LTD.**

ROLLED STEEL PRODUCTS (HOLDINGS) LTD. v *BRITISH STEEL CORPORATION*†

1. The Ultra Vires Doctrine in Company Law

The essence of the doctrine is, firstly, that a company incorporated under statute can pursue only those objects which are expressly authorised by statute or by the company's memorandum of association, and secondly that it possesses only those powers which are expressly conferred upon it by statute or its memorandum, or which must be implied as being reasonably incidental to the pursuit of its authorised objects. The doctrine was said to have a twofold purpose: to protect shareholders by ensuring that their investment was used only for the purposes for which the company had been formed; and to protect the company's creditors against dissipation of its funds in unauthorised activities.[1]

The very use of the term "*ultra vires*" indicates that the doctrine is concerned not with a duty placed on a company to confine its activities within the scope of its authorised objects, but instead with a company's *incapacity* to perform legally effective acts outside that scope. As a result an *ultra vires* transaction is "wholly null and void".[2] Several consequences have been held to follow from this. The first is that not even the unanimous agreement of the shareholders can validate a contract which is outside the powers of the company as expressed in the relevant Companies Act and the memorandum.[3] The second is that a defence of *ultra vires* is available in an action on the contract both to the company[4] and to the outside contracting party[5]. As regards remedies in quasi-contract, the position appears to be that in an action against the company such a remedy is not available if it would amount to indirect enforcement of the contract,[6] but that no such

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* [1982] 3 W.L.R. 431.

† [1982] 3 W.L.R. 715.

[1] *Ashbury Railway Carriage and Iron Co.* v. *Riche* (1875) L.R. 7 H.L. 653, at 667, *per* Lord Cairns, L.C.

[2] *Id.* 673.

[3] *Ibid.*

[4] *Ashbury Carriage Co.* v. *Riche, supra* n. 1; *Baroness Wenlock* v. *River Dee Company* (1855) 10 App. Cas. 354; *Re Jon Beauforte (London) Ltd.* [1953] Ch. 131.

[5] *Bell Houses Ltd.* v. *City Wall Properties Ltd.* [1966] 1 Q.B. 207 at first instance, the Court of Appeal not deciding the question; *Kathleen Investments (Australia) Ltd.* v. *Australian Atomic Energy Commission* (1978) 52 A.L.J.R. 46, *per* Barwick, C.J. at 52 and Stephen, J. at 58.

[6] *Sinclair* v. *Brougham* [1914] A.C. 398; *Re Edward Love & Co. Pty. Ltd.* [1969] V.R. 230; *Re Jon Beauforte (London) Ltd., supra* n. 4.

limitation prevents the company from relying on quasi-contract against the outsider.[7]

Although it was early decided that acts which are reasonably incidental to the authorised objects will be regarded as *intra vires*,[8] draftsmen assumed the practice of setting out explicitly all ancillary powers which might be required by the company, and furthermore, enumerating other substantive activities in which the company might want to engage in the future. Clearly a liberal interpretation of such widely-drafted objects clauses would undermine the existence of the whole doctrine, and the courts responded by employing a version of the *ejusdem generis* principle of construction. This involved identifying the "main" objects in the objects clause, and then construing widely-drawn powers as authorising their exercise only for purposes ancillary to the main objects.[9] Draftsmen countered by inserting at the end of the objects clause a paragraph stipulating that each of the foregoing paragraphs should be construed as independent and not subordinate or ancillary to any other paragraph, a technique which was held to be effective in *Cotman* v. *Brougham*.[10] However in *Re Introductions Ltd.*,[11] a limitation was placed on this device, to the effect that an independent objects clause is only effective in relation to "substantive objects" of the company.

In some cases a different attempt was made by the courts to counter the results of lengthy and widely-drawn objects clauses, by suggesting that an act would be *ultra vires* if it were not made "for the benefit and to promote the prosperity of the company".[12] However in *Charterbridge Corporation Ltd.* v. *Lloyd's Bank Ltd.*[13] Pennycuick, J. expressed the opinion that any such requirement was "quite inappropriate to the scope of express powers",[14] and this view was endorsed, at least in relation to those express powers which are also substantive objects, in both *In re Horsley & Weight Ltd.*[15] and *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corporation.*[16]

2. *In re Horsley & Weight Ltd.*

Substantive object or ancillary power: the effect of an independent objects clause.

The operation of an independent objects provision upon the particular paragraphs of an objects clause was explored by Buckley, J. (as he then was)

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[7] *Brougham* v. *Dwyer* (1913) 108 L.T. 504; 29 T.L.R. 234; *Re K.L. Tractors Ltd.* (1961) 106 C.L.R. 318; *City of Camberwell* v. *Cooper* [1930] V.L.R. 289; *Bell Houses* case, *supra* n. 5 at 266. See generally Vann, 52 *A.L.J.* 290.

[8] *A.-G.* v. *Great Eastern Railway Co.* (1880) 5 App. Cas. 473 at 478.

[9] *Re German Date Coffee Co.* (1882) 20 Ch. D. 169; *Evans* v. *Brunner Mond & Co. Ltd.* [1921] 1 Ch. 359.

[10] [1918] A.C. 514.

[11] [1968] 2 All E.R. 1221 (Buckley, J.), [1970] 1 Ch. 199 (Court of Appeal).

[12] *Re Lee, Behrens & Co. Ltd.* [1932] 2 Ch. 46 at 51, *per* Eve, J.

[13] [1970] 1 Ch. 62.

[14] *Id.* 71.

[15] [1982] 3 W.L.R. 431.

[16] [1982] 3 W.L.R. 715.

in *Re Introductions Ltd.*[17] The question for decision in that case was whether a power to borrow, expressed in quite general terms in the memorandum, could authorise a borrowing for the purposes of a business which was itself clearly *ultra vires*, in view of the fact that the memorandum contained an independent objects clause. Buckley, J. began by defining an independent object as "something which the company can carry on as its sole activity";[18] and he observed that the independent objects provision had to be read as being subject to implied exceptions to account for the fact that some "objects" in terms required that the company have other activities in addition to those carried on under the particular sub-clause.[19] Up to this point the reasoning is purely a matter of construction, since it involves reconciling the independent objects provision with sub-clauses which are in terms inconsistent with it. By contrast the power to borrow was expressed in general terms, and so there was on the face of it no such inconsistency; nonetheless Buckley, J. considered that the *nature* of borrowing requires that the company carry on in addition some other activity:

> Borrowing is only a sensible activity if it is associated with some use to which the borrowed money is proposed and intended to be put, and if one were to treat sub-cl. (N) [the borrowing power] as conferring on the plaintiff company the power to do something in isolation from any other activities at all as its sole activity, sub-cl. (N) becomes an irrational clause. . . . [T]he very nature of the transaction contemplated by sub-cl. (N) infers [*sic*], I think, that the company must have in view purposes to which the money shall be applied. That is to say, that the power to borrow or raise money is a power to borrow or raise money for the purposes of the plaintiff company. If that be the right way in which to construe the sub-clause, then it does not authorise borrowing or raising money for any purpose which is not a legitimate activity of the plaintiff company.[20]

Here the argument has moved beyond pure construction of the objects clause to look at what could be called the inherent rationality of the activities specified. In this sense Buckley, J. might be interpreted as saying that, as a matter of law, borrowing *simpliciter* is incapable of being an independent object of a company, and if so then that proposition would have the character of precedent for subsequent cases. The final step in the analysis is the statement that for a borrowing to be *intra vires* it must be for purposes which are "legitimate activities" of the company,[21] the inference being that those activities are the independent objects specified in the memorandum.

With respect, the weakness in this approach lies right at the start of the reasoning, in the use of the "sole activity" test for determining whether a

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[17] *Supra* n. 11.
[18] *Id.* 1225.
[19] *Id.* 1224.
[20] *Id.* 1227.
[21] *Id.* 1225.

particular sub-clause is able to constitute an independent object. There is no necessary reason why the objects which a company may lawfully pursue should be determined by the question whether each one of those objects is capable of being pursued in isolation from all other activities.[22]

That the distinction between independent objects and merely ancillary powers is by no means clear-cut can be seen from a comparison of *Re Introductions* with *In re Horsley & Weight Ltd.*[23] In that case Frank Horsley and Mr. Campbell-Dick together held all the issued shares in Horsley & Weight Ltd. The directors were Frank Horsley and Mr. Campbell-Dick and their wives, and Frank's father Mr. Stephen Horsley, but in fact board meetings were not held and the conduct of the company's financial affairs was in the hands of Mr. Campbell-Dick. The company purchased a pension policy for Mr. Stephen Horsley's benefit, the proposal form and premium cheques being signed by Frank and Campbell-Dick. Upon the making of a winding-up order, the liquidator sought declarations that Stephen Horsley was guilty of misfeasance and breach of trust in procuring the company to take out the policy,[24] and that he held it or its proceeds upon trust for the company. There were two grounds for the allegation of misfeasance: firstly that the purchase was *ultra vires* the company; alternatively, if the purchase was *intra vires*, that it constituted a breach of an alleged duty incumbent on the directors not to expend the company's capital fund otherwise than for the intended benefit of the company, and that such breach had not been validated by the fact that the only two shareholders had approved the transaction.

Oliver, J. rejected the claim, and the Court of Appeal, comprising Buckley, Cumming-Bruce and Templeman, L.JJ., dismissed an appeal, holding that:

(i) the purchase was *intra vires* the company;

(ii) no misfeasance on the part of Mr. Horsley had been proved; and

(iii) although the decision to purchase the policy had not been taken by the board, as required by the articles, this irregularity had been cured by the unanimous assent of the members of the company.

The leading judgment in the Court of Appeal was delivered by Buckley, L.J. He began by briefly summarising the analysis he had developed in *Re Introductions*, reiterating the sole activity test for independent objects and coining the term "substantive objects" to distinguish them from mere powers.[25] In particular he restated the two bases upon

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[22] *Cf.* Wedderburn (1969) 32 *Mod. L.R.* at 565.

[23] *Supra* n. 15.

[24] The liquidator was proceeding under s. 333(1) of the Companies Act 1948 (U.K.) which provides that "If in the course of winding up a company it appears that any . . . past or present director . . . has misapplied . . . any money . . . or been guilty of any misfeasance or breach of trust in relation to the company, the court may, on the application . . . of the liquidator . . . compel him to repay or restore the money . . . by way of compensation in respect of the . . . misfeasance or breach of trust as the court thinks just".

[25] *Supra* n. 15 at 437.

which an express "object" may be relegated to the status of ancillary power: "objects" which do not satisfy the sole activity test:

> . . . must, *by reason of their very nature*, be interpreted merely as powers incidental to the true objects of the company and must be so treated notwithstanding the presence of a separate objects clause. . . . Where there is no separate objects clause, some of the express "objects" may *upon construction* fall to be treated as no more than powers which are ancillary to the dominant or main objects of the company. . . . [I]n 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 powers can only be intra vires if it is in fact ancillary or incidental to the pursuit of some such dominant or main object.[26]

His Lordship proceeded to determine whether the granting of pensions to directors was a substantive object. Paragraph (o) of the objects clause was in the following terms:

> (o) To grant pensions to employees and ex-employees and directors and ex-directors or other officers or ex-officers of the company, their widows, children and dependents, and to subscribe to benevolent and other funds for the benefit of any such persons and to subscribe to or assist in the promotion of any charitable benevolent or public purpose or object.

The memorandum also included a separate objects provision. Buckley, L.J. reasoned as follows: paragraph (o) "must be read as a whole";[27] the paragraph includes the object of making grants for charitable, benevolent or public purposes, and the making of such grants is capable of being the sole activity of a company; "the purposes referred to in [paragraph (o)] are such as to be capable of subsisting as substantive objects of the company and, having regard to the separate objects clause, must be so construed";[28] hence the granting of pensions to directors is a substantive object. It is obvious that the linch-pin of this reasoning is the postulate that a sub-clause of an objects clause must be read as a whole, but it is submitted that some limitation must be placed on this principle. If his Lordship is saying that once one activity mentioned in a sub-clause satisfies the sole activity test then all other activities in the sub-clause are capable of being substantive objects, then clearly it would be possible to draft objects clauses in such a way as to undermine the whole substantive object/ancillary power distinction. *Prima facie* the granting of pensions to directors and ex-directors would seem to be a suitable candidate for failure on the sole activities test. The limiting factor must be some requirement of sufficient connection between the various activities mentioned in the sub-clause for it to be read as a whole. For example, it cannot be the case that the decision in *Re In-*

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[26] *Ibid.*, emphasis added.
[27] *Id.* 438.
[28] *Id.* 439.

troductions would have been different had the sub-clause been drafted in the form "To borrow, and to make grants for charitable purposes". In the Court of Appeal in *Re Introductions* Harman, L.J. said, *à propos* independent objects clauses, "you cannot convert a power into an object merely by saying so",[29] and the same must be said with respect to the contents of a single sub-clause.

The other members of the Court in *Horsley & Weight* saw the objects/powers distinction purely as a matter of construction,[30] but without considering the problem raised for this approach by the presence of the separate objects clause.

In *Rolled Steel Products*[31] one issue was whether a power to give guarantees was a substantive object or an ancillary power. After quoting[32] the passage cited above[33] from *Horsley & Weight*, in which Buckley, L.J. distinguished the "construction" of the sub-clause from the "very nature" of the activities mentioned in it, Vinelott, J. went on to state that "The question whether a stated object is truly an independent object or purpose is always a question of construction".[34] This approach involves seeing it as permissible to ignore the separate objects clause. It is submitted that Buckley, L.J.'s approach[35] is preferable, since it recognizes that where there is a separate objects clause, the court is justified in refusing to give effect to it only on the basis that this is required by the inherent rationality or "very nature" of the activity in question. Where there is no separate objects clause, the holding that an activity is a mere power is justified either on that basis, or else as a matter of construction.

Since in *Horsley & Weight* the dispute did not involve the other party to the allegedly *ultra vires* contract,[36] the issue of the consequences to such a party of the transaction being held to be *ultra vires* did not arise. By contrast, this issue was a major one on the facts of *Rolled Steel Products*.

3. *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corporation*

Extent of power/Abuse of power

The reason why it is seen as important, in cases such as *Re Introductions* and *Horsley & Weight*, to classify a particular paragraph of an objects clause as representing either a substantive object or an ancillary power, is that that categorisation dictates whether the *purpose* of a company's act is relevant in determining whether the act is *intra vires* or *ultra vires*. If the sub-clause in question represents a substantive object of the company, any act which falls within the scope of its literal terms is *intra vires* the company; if on the other hand the sub-clause represents a merely ancillary

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[29] *Supra* n. 11 at 210.
[30] *Supra* n. 15 at 442 (Cumming-Bruce, L.J.), and at 443 (Templeman, L.J.).
[31] *Supra* n. 16.
[32] *Id.* 730.
[33] *Supra* n. 26.
[34] *Supra* n. 16 at 732.
[35] *Supra* n. 26.
[36] *Supra* n. 15 at 437.

power, a purported exercise of that power will only be *intra vires* if it is undertaken for a purpose which itself is within the scope of some substantive object expressed in the memorandum. This latter proposition is founded on a certain view of the relationship between the purpose of an exercise of power and the effectiveness of that exercise. It assumes that certain authorised purposes are essential or interior to the power itself; that is to say, if the power conferred is only a power to pursue an authorised object, then the absence of an authorised object means that the power conferred has not been exercised at all, but rather the exercise has been of some other power. For example, in *Re Introductions* Buckley, J. held that the power conferred was a power to borrow for an authorised purpose (*i.e.* a substantive object) of the company; on the basis of the above assumption, he concluded that the borrowing, which had been for an unauthorised purpose, was not an exercise of the power which had been conferred; the implication is that the power which the company had purported to exercise (*i.e.* a power to borrow for the purposes of pig-breeding) was not one which had been conferred on it. This analysis of the exercise of a power for an unauthorised purpose might be called the *"excess of power" approach.* The consequence of holding that an act is in excess of power is that the transaction is "wholly null and void"[37] and thus incapable of conferring rights on an outside party whether or not he had notice of the excess.

That this type of analysis is the most appropriate one in the context of corporate powers is by no means self-evident. As Oliver, J. has observed, it does not follow that "because a power must not be abused, therefore beyond the limits of propriety it does not exist".[38] An analysis which does contemplate the existence of a power beyond those limits would posit that the purpose for which a power is used is something exterior to the power, so that its use for an unauthorised purpose is nonetheless an exercise of *that particular power.* This is the analysis normally employed in cases where the law imposes a *duty* on a person to use a particular power only in a certain way. In the context of companies, where there is a duty on, for example, the board of directors or a majority in the general meeting to exercise a power only for certain purposes, then its use for any other purpose will be a breach of that duty but not necessarily a deficiency of power: there is an *abuse* of the power, but the act may still be *intra vires.* This second type of analysis may be called the *"abuse of power" approach.* Whereas excess of power (in the case of legal powers) was a limitation imposed at common law, restraints on the abuse of power were developed in equity; they are concerned not with the *capacity* to perform legally effective acts but instead with the *propriety* of acts, regardless of their effectiveness at law. The abuse of power approach entered company law through the imposition by equity of fiduciary duties on directors and other company agents.

In the present context there are three significant consequences of the

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[37] *Supra* n. 2.

[38] *In re Halt Garage Ltd.* [1982] 3 All E.R. 1016, quoted in *Rolled Steel, supra* n. 16 at 733.

distinction between excess of power and abuse of power. The first relates to the effectiveness of an abusive act:

> Where a power is exercised for a purpose not within its proper scope, it has, in general, been held that the transaction thereby effected is not void, but voidable, if the power is a legal power (a power giving rise to rights enforceable at law) and not a mere equitable power. . . . In such a case, it has been said, the evidence of the power will be operative at law, and it will be necessary to seek the intervention of equity to set aside the effect of the exercise at law.[39]

In the second place, an exercise of power by the directors which is abusive because made for an improper purpose may be affirmed, in certain circumstances, by the shareholders in general meeting, although the precise juridicial fundament of such "ratification" is unclear.[40] Finally, because an abusive exercise of power is voidable only in equity, it can have the effect of conferring indefeasible rights on outsiders dealing with the company. If legal rights have become vested in an outsider who has given value and did not at the time have notice of the abuse of power (*i.e.* of the improper purpose) then those legal rights will prevail over the company's equity to avoid the transaction. If the outsider has received a full equitable estate in property, then his interest will still prevail, since the company's right of avoidance is a "mere" equity to take proceedings to have the transaction set aside.[41]

Some cases have combined elements of both the "excess of power" and "abuse of power" approaches; two significant examples are *Re David Payne & Co. Ltd.*[42] and *Re Introductions*. In both those cases a company with a general power to borrow, borrowed money and subsequently applied it in a business which was not authorised by its memorandum. In each case it was said that the misapplication of the money by the company would not avoid the loan in the absence of knowledge on the part of the lender that the money was intended to be misapplied.[43] Since the intention of the controllers of the company and the lender's knowledge of that intention were held to be relevant, on a traditional view one might have thought that the cases were being decided in terms of directors' duties. Yet in both cases the borrowing transactions were held to be *"ultra vires"*.

The apparent anomaly involved in these cases was discussed in *Rolled Steel Products* and an attempt was made to account for it. In that case, a Mr. Shenkman held 51 per cent of the shares in R.S.P. Ltd., the remaining shares being held by the trustees of a settlement in favour of his children; the directors were Shenkman and his father. Shenkman also held all the shares in another company, S.S.S. Ltd. S.S.S. owed £860,000 to Colvilles

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[39] *Winthrop Investments Ltd.* v. *Winns Ltd.* [1975] 2 N.S.W.L.R. 666 at 689, *per* Mahoney, J.A.

[40] *Ibid.*

[41] See *Street Nominees Pty. Ltd.* v. *White Industries Ltd.* (1980) 5 A.C.L.R. 40.

[42] [1904] 2 Ch. 608.

[43] This formulation, taken from the headnote of *Re David Payne*, *ibid.*, was endorsed by Harman, L.J. in *Re Introductions*, *supra* n. 11 at 210-211, and by Vinelott, J. in *Rolled Steel*, *supra* n. 16 at 734.

Ltd., which debt Shenkman had personally guaranteed. When Colvilles pressed for further security the directors of R.S.P. resolved that the company should guarantee the amount owed by S.S.S., and the trustees consented to this scheme. The objects clause in R.S.P.'s memorandum of association included this sub-clause:

> (k) To lend and advance money or give credit to such persons, firms, or companies and on such terms as may seem expedient, and in particular to customers of and others having dealings with the company, and to give guarantees or become security for any such persons, firms, or companies.

The memorandum also contained a "separate objects" clause. R.S.P.'s articles provided that if a director declared his interest in a contract to be entered into by the company he was to be counted in the quorum at a board meeting which considered that contract and was entitled to vote in respect of it. The quorum was two directors. Although the effect of a guarantee given by R.S.P. would be to reduce the liability under his own guarantee, Shenkman did not make a declaration of that interest and consequently the board meeting was inquorate.

The liquidator of R.S.P. brought an action against the British Steel Corporation as successor to Colvilles, claiming a declaration that the guarantee was *ultra vires* on the ground that it had not been made for the purposes of R.S.P. Vinelott, J. held that the transaction was *ultra vires* because it had not been entered into for an authorised purpose of the company, that Colvilles knew this, and that consequently R.S.P. was entitled to have the guarantee set aside.

At the conclusion of argument the defendant sought leave to amend its defence to include a claim that the invalidity of the board resolution due to the lack of a quorum had been cured by the unanimous consent of the shareholders. Vinelott, J. refused leave but went on to hold that in any case because the transaction was *ultra vires* it could not be ratified by the members.[44]

In his judgment Vinelott, J. discussed the decisions in *Re David Payne* and *Re Introductions* and drew attention to the difficulty inherent in treating the outsider's knowledge as decisive of the question whether he can recover on an *ultra vires* contract; nevertheless he seemed to accept those cases as good law and attempted to explain their use of the expression *"ultra vires"* by distinguishing two uses of that term:

> It is used in a narrow sense to describe a transaction which is outside the scope of the powers expressed in the memorandum of association of a company or which can be implied as reasonably incidental to the furtherance of the objects thereby authorised. . . . The phrase *"ultra vires"* is also used to describe a transaction which, although it falls

[44] *Supra* n. 16 at 742-744.

> within the scope of the powers of a company, express or implied, is entered into in furtherance of some purpose which is not an authorised purpose.[45]

His Lordship went on to describe the characteristics of *ultra vires* in each of these two senses in the following way:

> The reason why a transaction which is within the powers, express or implied, of a company but which is entered into for a purpose which is not authorised by its memorandum of association is equated with one which is *ultra vires* in the narrow sense is, I think, that such a transaction like a transaction which is *ultra vires* in the narrow sense is incapable of being made binding on the company even by the assent of all the members. The members cannot authorise the use of the company's property for a purpose other than the purposes which the company is authorised to pursue by its memorandum of association. The difference between a transaction which is *ultra vires* in the narrow sense and one which is *ultra vires* in the wider sense is, of course, that a transaction which is *ultra vires* in the narrow sense is altogether void and cannot confer rights on third parties whereas a transaction which is *ultra vires* in the wider sense may confer rights on a third party who can show that he dealt with the company in good faith and for valuable consideration and did not have notice of the fact that the transaction, while ostensibly within the powers, express or implied, of the company, was entered into in furtherance of a purpose which was not an authorised purpose.[46]

Vinelott, J. maintained that the concept of "*ultra vires* in the wider sense" is consistent with the decision of the Court of Appeal in *Re Introductions*, "where Harman, L.J. and Russell, L.J. refer to the borrowing as 'made for the purposes of an *ultra vires* business' but do not describe the borrowing itself as *ultra vires*".[47] As noted above, the problem with *Re Introductions* is that it involved a combination of the abuse of power and excess of power approaches, and a conflation of legal and equitable doctrine. Vinelott, J.'s concept provides a label for the decision in that case but goes no further towards elucidating its difficulties. In particular the mechanics of the process by which a transaction "may confer rights on a third party" are not immediately apparent. Presumably an act which is *ultra vires* in the wide sense is in fact *intra vires* (in the narrow sense) so that legal rights are conferred, and it would be necessary to seek the intervention of equity to obtain relief; if this is so, then the court will consider not only the state of knowledge of the other party but also the company's own conduct in deciding whether to grant such relief.

The basic proposition of *Re Introductions* is that an ancillary power can only be exercised for an authorised purpose (*i.e.* a substantive object).

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[45] *Id.* 733.
[46] *Id.* 734.
[47] *Id.* 733.

The difficulty with this is *how to determine the purpose* of an exercise of power objectively from the circumstances of a given transaction. In *Re Introductions* itself the company was only carrying on one business, which was unauthorised, and so the inference that the transaction was entered into for an unauthorised purpose could easily be drawn. However in cases where, for example, the company is carrying on both authorised and unauthorised businesses, it may be impossible to say what was the purpose of the transaction without relying heavily on evidence of either the subjective intention of the company's controllers or events subsequent to the transaction. But reliance on either of those types of evidence sits uncomfortably with the theory of corporate capacity as usually understood. A company's capacity should in principle be determined by reference to its memorandum of association, and "it would be contrary to the whole function of a memorandum that objects unequivocally set out in it should be subject to some implied limitation by reference to the state of mind of the parties concerned".[48] And principle also dictates that the question of capacity must be susceptible of determination at the time of the transaction in question.

In general the cases have failed to advert to the fact that different powers may stand in a variety of relationships to the purposes for which they are exercised. Some powers, of their nature, are likely to be exercised in such a way that it will be possible to ascertain objectively the purpose of the transaction from the circumstances. A good example is a power to draw and issue cheques:[49] for any particular cheque, taking into account the payee, the amount, prior dealings between the payee, the company and the agent who drew the cheque, the financial situations of those parties, whether the amount has to be repaid and on what terms, and so on, it may well be possible to determine the purpose for which it was drawn.[50] In such a case, the purpose of exercising the power may be achieved in the very act of its exercise, or at least it will be implicit in the transaction. Powers which are of this type could be called, by way of shorthand, *"introspective" powers.* In contrast it is quite likely that the circumstances surrounding a borrowing will reveal little about its purpose. This is because the ultimate destination of borrowed moneys is not comprehended within the borrowing transaction itself. Money (notwithstanding any contractual stipulation) is always capable of being applied in a variety of ways; at the time of the borrowing any application of the money can only be something *intended.* Powers which fall into this category will be called, for short, *"prospective" powers.*

Having regard to excess of power and abuse of power as alternative forms of analysis, it can be shown that those two approaches are not equally appropriate to both kinds of powers. Introspective powers can be analysed without too much difficulty under the excess of power approach: because the party dealing with the company should be able, at the time of the tran-

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[48] *Supra* n. 13 at 69, *per* Pennycuick, J.

[49] The following discussion proceeds on the assumption that such a power would be construed as an ancillary power, which is by no means certain.

[50] *Cf. International Sales Ltd.* v. *Marcus* [1982] 3 All E.R. 551.

saction, to ascertain the company's purpose, it should not be productive of injustice to hold that the company's act is outside power if the purpose is unauthorised. But in the case of prospective powers, where the purpose may not be decisively apparent at the time of the transaction, if the law is to employ an excess of power analysis the outside party will be put in an invidious position: even though an outsider is not bound to inquire into purposes,[51] nonetheless the validity of the transaction does depend on the purpose and the purpose is not apparent. Furthermore, from the point of view of doctrinal consistency, under the excess of power approach the knowledge of the other party as to purposes should be irrelevant, and it should be superfluous to state that he is not bound to inquire. If, as the justice of the case may require, it is desirable to take account of the other party's knowledge in deciding whether he can recover, it is preferable to adopt an abuse of power analysis in which that knowledge plays an integral part.

Wide *ultra vires* tries to have it both ways by holding that a transaction "is incapable of being made binding on the company even by the assent of all the members" (excess of power), while stating at the same time that it "may confer rights on a third party who can show that he . . . did not have notice" (abuse of power). Because the purpose for which a prospective power is exercised can never be known for certain at the time of its exercise it is the contention of the present writers that the application of the concept of wide *ultra vires* to cases involving prospective powers must be rejected.

In *Rolled Steel* itself, Vinelott, J. found that the power to give guarantees contained in sub-clause (k) was an ancillary power, and that, although the guarantee fell within the literal terms of that power, the circumstances showed that it had not been given for any substantive object of R.S.P., but rather to benefit Mr. Shenkman. Applying the concept of wide *ultra vires*, his Lordship then turned to the question of whether Colvilles knew of the improper purpose, and found that they did; consequently, they could not rely on the guarantee and were ordered to refund the moneys paid over by R.S.P.[52]

Analysis shows that a power to give guarantees is an introspective power, and so the difficulties recited above as regards the application of wide *ultra vires* to prospective powers do not arise. Moreover it could be strongly argued that the justice of the case did require the result which was reached. The guarantee was given in response to threats made by Colvilles to put S.S.S. into liquidation and to bankrupt Shenkman by calling on him to perform his own guarantee. It rendered R.S.P. potentially liable to the extent of virtually all its assets, and if it had to be honoured liquidation would be inevitable, with disastrous consequences to R.S.P.'s other creditors. In view of the fact that Colvilles knew all this, it would have been unfair to allow them to rely on the guarantee so as to achieve an advantage over the other creditors.

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[51] *Supra* nn. 11 and 42.
[52] *Supra* n. 16 at 735 ff.

It is clear that Shenkman was in breach of his duty as director in procuring the company to give the guarantee, thus reducing his personal liability. This rendered the transaction voidable at the instance of R.S.P., given that Colvilles had knowledge of the circumstances amounting to the breach. But the only two shareholders (Shenkman and the trustees) consented to the guarantee and had thus ratified the breach. Consequently the law of directors' duties could not be invoked to set aside the transaction, despite the fact that ratification was achieved by the act of the director in breach, in his capacity as controlling shareholder.

Where the controlling shareholder of a company is also one of its directors, it may be undesirable to allow that person in his capacity as shareholder to ratify a breach of his duty as director, especially in circumstances where liquidation is imminent. The possibility of ratification is circumscribed to some extent by the requirement that it not amount to a fraud on minority shareholders, but this limitation affords no protection to creditors. Vinelott, J.'s concept of wide *ultra vires* may have been formulated to avoid the validating effect of ratification which would, in the instant case, have flowed from applying the law of directors' duties; in addition it allowed the court to take into account the innocence or otherwise of the other party. But, as argued above, there will be cases in which the circumstances of the exercise of power will render it impossible to ascertain the purpose objectively and consequently to employ wide *ultra vires* without the risk of injustice.

It may be that a solution is indicated by *obiter dicta* of the Court of Appeal in *Horsley & Weight*. On the facts it was unnecessary to decide whether, had misfeasance by the directors been proved, it would have been open to them in their capacity as shareholders to ratify the breach, but Cumming-Bruce, L.J., adverting to that possibility, observed: "It would surprise me to find that the law is to be so understood".[53] Templeman, L.J. expressed the same opinion more strongly:

> I am not satisfied that the directors convicted of such misfeasance . . . could excuse themselves because two of them held all the issued shares in the company and as shareholders ratified their own gross negligence as directors which inflicted loss on creditors.[54]

4. Conclusion

It is submitted that:

(i) the substantive object/ancillary power distinction should be rejected, due to its uncertainty;

(ii) cases involving a conflation of excess of power and abuse of power approaches should not be followed because they confuse legal and equitable doctrines;

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[53] *Supra* n. 15 at 443.
[54] *Id.* 444.

(iii) the concept of *ultra vires* in the wider sense should not be used because of the difficulty of determining the purpose for which a power is exercised, especially in the case of prospective powers;

(iv) objectionable consequences flowing from the ratification by directors who are controlling shareholders of their own breaches of duty should be dealt with by a development of the law of directors' duties.

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