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THE DOCTRINE OF ULTRA VIRES IN UNITED STATES SUPREME COURT DECISIONS*

CLYDE L. COLSON**

C. The Court's Reasons for its Strict Doctrine as to Ultra Vires Contracts

Consider next what the Court in the Thomas case called the "sound principle" underlying its doctrine of ultra vires contracts. A good statement of this principle is found in the Central Transportation Company case:

"All contracts made by a corporation beyond the scope of those powers are unlawful and void, and no action can be maintained upon them in the courts, and this upon three distinct grounds: the obligation of every one contracting with a corporation, to take notice of the legal limits of its powers; the interest of the stockholders, not to be subjected to risks which they have never undertaken; and, above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law."

(1) Notice of the corporation's lack of authority.

Although at one time most courts were imbued with the idea that because the charter and applicable statutes are matters of public record every person who deals with a corporation has notice of the limits of its authority, fortunately at the present time this notion is pretty well exploded in a majority of American jurisdictions. And while some courts like the Supreme Court still bring this idea to bolster up their decisions when no recovery is to be allowed on the transaction in question, they completely disregard it in those other and more numerous cases where the transaction is held valid.

Everyone should admit that under present business conditions it is wholly futile to expect that a party to an ordinary transaction with a corporation will make an examination of its charter and of the general statutes under which it was formed. Aside from the fact that the volume of business done makes such examination well-nigh a physical impossibility, there is the additional con-

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sideration that if the examination were made, only a lawyer would be able to render a reliable opinion on the matter and even he would often be at a loss in those cases where the law is unsettled. It is not surprising that a legal requirement which is so impracticable and which, if enforced, would constitute such a check on normal business intercourse should have been given up by most courts.

Originally this requirement seems to have been tied in with the notion that ultra vires transactions are illegal and that parties to such transactions are chargeable with notice of their illegality. However, with the realization that ultra vires transactions are not necessarily illegal, this reason for constructive notice disappears.

Admittedly the case is different if the person dealing with the corporation has or as a reasonable man should have actual notice that the transaction is ultra vires. The corporation always has or is chargeable with notice of its own lack of authority. Whenever, then, both the parties to the contract know that it is ultra vires, the law may well deny recovery both at law and in equity, and this on the ground that there is no policy favoring the security of such transactions but that rather there is a policy against them. Certainly, when in a weighing of the interests involved the main one demanding that the transaction be upheld is lacking, the interests of non-assenting stockholders and the policy of the state against unauthorized corporate action may well be allowed to prevail.

(2) The interests of non-assenting stockholders.

Since the doctrine of ultra vires as stated by the Supreme Court is so strict that even if all the stockholders have assented, the transaction is nevertheless void, the protection of the interests of non-assenting stockholders must have been regarded by the Court as merely an additional reason for holding the transaction invalid. On the contrary, however, it would seem that this is the strongest argument that can be made in favor of the doctrine, for it is unquestionably true that those who furnish the capital must be given the assistance of the law to see that their interests are not endangered by unanticipated and unauthorized corporate action.

Consequently, if there were no other way to protect their interests than by declaring all ultra vires transactions void, it
would be arguable that such should be the rule. And while in fact the application of this rule might as often work an impairment of the stockholder's interests, which would be the case when the party who was dealing with the corporation escapes liability, as it works in favor of them when the corporation escapes, it may nevertheless be true that in the long run the rule would operate as a wholesome deterrent of such transactions and would thus be a real protection to the non-assenting stockholder. But if he is sufficiently cared for in other ways, there is certainly no reason why the law should give him this additional protection, particularly when to do so runs counter to the policy favoring the security of business transactions.

Let us see then to what extent the interests of the non-assenting stockholder are otherwise protected. To begin with, it is well settled that a director or other officer is liable to the corporation for any loss suffered through his causing it to engage in an *ultra vires* transaction.\(^{131}\) It is also well settled that in such case a stockholder may bring a derivative suit in equity to compel payment to the corporation if it refuses or is unable to sue.\(^{132}\) Also, the dissenting stockholder in his individual capacity is allowed to enjoin a threatened *ultra vires* act.\(^{133}\) Although on principle it seems extremely doubtful whether the injunction should be granted in the intermediate case where an *ultra vires* contract has been made but the corporation has not yet performed, the Supreme Court has held that the injunction should issue.\(^{134}\) And in accordance with the majority rule in America that a purely executory *ultra vires* contract is unenforceable, most states would probably allow the injunction where neither party had performed. Also, where as in the Supreme Court the contract remains unenforceable even after performance on one side, the injunction would be granted. But if the view is adopted than an executory *ultra vires* contract is enforceable or if the contract has become valid by reason of performance by the other party, it seems that the stockholder should be limited to his right to bring a derivative suit to compel those

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\(^{132}\) Ballantine, id. §§ 188-195, at 616 and following.

\(^{133}\) Dodge v. Woolsey, 18 How. 331, 341, 15 L. Ed. 401 (1855); Ry. Co. v. Allerton, 18 Wall 233, 21 L. Ed. 902 (1873).

THE DOCTRINE OF ULTRA VIRES

responsible for the unauthorized contract to repair any damage done the corporation.\textsuperscript{135}

There is also the additional consideration that as a practical matter these actions by stockholders are very often nuisance suits only, which has led to restrictions by equity courts on the right to bring such actions. It is clear that a professional agitator will be denied relief if it can be shown that his action is not \textit{bona fide}.\textsuperscript{136} But such proof is necessarily difficult and this fact has led to the restriction in some courts that the stockholder must have owned his stock at the time of the injury complained of, which at least prevents the purchase of the stock for the purpose of bringing the suit.

That this practical consideration is part of the reason behind this requirement in the federal courts is borne out by a statement in \textit{Dimpfell v. Ohio R. R. Co.} where the Supreme Court said:

"And it does not appear that the complainants owned their shares when these transactions took place. For aught we can see to the contrary, they may have purchased the shares long afterwards, expressly to annoy and vex the company, in the hope that they might thereby extort, from its fears, a larger benefit than the other stockholders have received or may reasonably expect from the purchase, or compel the company to buy their shares at prices above the market value. Unfortunately, litigation against large companies is often instituted by individual stockholders from no higher motive."\textsuperscript{137}

This case also brings out the proposition that as a further protection against this danger the stockholder’s right to relief will be barred unless he has been prompt and diligent in the exercise of his right. It should be added that the additional danger that derivative suits in the federal courts may be collusive in order to confer jurisdiction on the ground of diversity of citizenship has led the Supreme Court to place still more rigid restrictions on the stockholder’s right to sue.\textsuperscript{138}


\textsuperscript{137} 110 U. S. 209, 210, 3 S. Ct. 573 (1884). See also Home Fire Ins. Co. v. Barber, 67 Neb. 644, 656, 93 N. W. 1024 (1903), where Dean (then Commissioner) Pound said, "Sound reason and good authority sustain the rule that a purchaser of stock cannot complain of the prior acts and management of the corporation."

\textsuperscript{138} Hawes v. Oakland, 104 U. S. 450, 26 L. Ed. 827 (1881). This decision led to the promulgation of former Equity Rule No. 94, present Equity Rule No. 27.
All these safeguards bear testimony to the fact that these stockholder’s suits are quite often not bona fide. If on the other hand, however, the action is brought in good faith, equity has always been astute to protect the interests of the dissenting stockholders. It is believed that this protection is sufficient to care for their legitimate complaints and that it is not necessary to give them the additional protection derived from the rule that ultra vires transactions are void. Here again it should be noted that however strong this reason for the Court’s doctrine may be, the Court has never hesitated to subordinate the interests of non-assenting stockholders to other interests when all things considered it was thought desirable to give validity to the ultra vires action.

(3) The policy of the law that corporations should not transcend their authority.

Although according to the Supreme Court the policy in favor of keeping a corporation within the limits of its authority is the interest which “above all” demands that ultra vires transactions be held illegal and void, it is difficult to work up any enthusiasm over this supposedly paramount interest. To be sure, such a policy does exist, as witness the right of the state to forfeit the charter of the corporation or oust it from the ultra vires business. But when it is observed that in practice the state seldom takes such action, it is a necessary conclusion that this policy must not be so strong after all.

The Supreme Court’s emphasis on this point is nothing more than a hangover from the early legal prejudice against corporations. There was a very real basis in fact for this jealousy at a time when most of the corporations with which the law had to deal were of a more or less monopolistic character and when charters were obtainable only by royal grant. But today when a new charter or an amendment to the old one conferring almost any conceivable authority can be obtained merely by going through the formality of filing certain papers with the proper state official, such a jealous attitude is wholly unwarranted.

Although the Supreme Court has repeatedly referred to ultra vires contracts as “unlawful” or “illegal” and therefore void, it has constantly admitted that the policy against unauthorized corporate action is not so strong as to make all transactions in con-
travention of it illegal in the true sense. This admission has been made in every case where the Court has given validity to the transaction either directly or indirectly. Whether the addition of the policy against unauthorized transfers by public service companies is enough to make the contract truly illegal is arguable, but even there the Supreme Court has admitted that it is not by allowing recovery in quasi-contracts.

It would seem then that none of the reasons assigned by the Court for its strict doctrine is sufficient to support it. In most of the cases where the doctrine has been applied the Court has failed to give proper consideration to opposing interests, particularly the interest in the security of business transactions. And it is believed that when and if the Court makes a thoroughly conscious and conscientious weighing of the interests involved, it will be forced to a recognition that not only is its doctrine unwarranted by the reasons which have been given in justification of it, but that it is also wholly unsuited to the actual conditions under which modern corporations operate.

D. Cases in which the Court has Repudiated its Strict Doctrine

(1) The so-called "abuse of a power".

Reference has already been made to the fact that there were two main lines of retreat used by the Court in its abandonment of the extreme position which it first took in regard to ultra vires contracts. One of these lines of retreat was the alleged distinction between an abuse of authority and an entire lack of authority. To be sure, the Court denies that this constitutes a repudiation of its doctrine. However, a consideration of the cases where this distinction has been made will show that it is of very doubtful validity.

In Zabriskie v. Cleveland R. R. Co.,130 a stockholder brought suit for an injunction against the payment of interest on the bonds of another railroad which had been guaranteed by the defendant corporation. The plaintiff also asked that upon a declaration that the guaranty was void as beyond the authority of the corporation a permanent injunction be issued against the use of any of its assets for the redemption of the bonds. A statute of Ohio authorized railway companies,

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130 23 How. 381, 16 L. Ed. 488 (1859).
"... by means of their subscription to the capital stock of any other company, or otherwise, to aid such company in the construction of its railroad, for the purpose of forming a connection. ... Provided, that no such aid shall be furnished ... until a meeting of the stockholders ... shall have been called ... and the holders of at least two-thirds of the stock of such company represented at such meeting ... shall have assented thereto." \(\textsuperscript{140}\)

Admittedly this proviso had not been complied with. Although a stockholders' meeting was called at which a resolution in favor of the guaranty was adopted without a dissenting vote, more than two-thirds of the stock represented was not voted.

In holding that the guaranty was \textit{intra vires} the Court said:

"This principle does not impugn the doctrine that a corporation cannot vary from the object of its creation, and that persons dealing with a company must take notice of whatever is contained in the law of their (sic) organization. ... But the principle includes those cases in which a corporation acts within the range of its general authority, but fails to comply with some formality or regulation which it should not have neglected, but which it has chosen to disregard." \(\textsuperscript{141}\)

The considerations which the Court felt to be controlling in this case were well stated:

"These negotiable securities have been placed on sale in the community, accompanied by these resolutions and votes, inviting public confidence. They have circulated without an effort on the part of the corporation or corporators to restrain them, or to disabuse those who were influenced by these apparently official acts. Men have invested their money on the assurance they have afforded.

"A corporation, quite as much as an individual, is held to a careful adherence to truth in their (sic) dealings with mankind, and cannot, by their representations or silence, involve others in onerous engagements, and then defeat the calculations and claims their own conduct had superinduced." \(\textsuperscript{142}\)

Of course, the result reached in this case is an eminently sound one. Such criticism of the decision as can be made must be directed at the reasoning. To begin with, the justification which the Court gives for its result really proves too much. It is quite

\(\textsuperscript{140}\) \textit{Id.} at 396.
\(\textsuperscript{141}\) \textit{Id.} at 398.
\(\textsuperscript{142}\) \textit{Id.} at 400-401.
true that in such a case as this most of the force is taken out of one of the grounds on which the Court bases its doctrine of ultra vires, that everyone dealing with a corporation is charged with notice of the provisions of its charter and of the applicable statutes. For if upon an examination of them it is found that the corporation has authority upon compliance with certain conditions precedent, one may as a reasonable man presume that such conditions have been met, particularly if the corporation represents that they have. Any other rule would be most unjust because whether the conditions have been complied with is a fact peculiarly within the knowledge of the corporation and one which the party dealing with the corporation has no means of ascertaining.

Without doubt a situation like this theoretically strengthens the position of the party dealing with the corporation and weakens one of the bases of the Court’s doctrine. It was said that this is only theoretically true because this line of reasoning presupposes that an examination of the charter and the statutes has been made which is certainly not so in a majority of cases. And if on the other hand it is true that even in the case where the corporation has no authority whatever this doctrine of constructive notice is wholly impracticable under modern conditions, it is difficult to see how the considerations of policy which influenced the Court in this case are any more applicable to the one situation than to the other. As a practical matter the position of the innocent bondholder would be just the same whether the corporation had no authority at all or had authority upon condition, and the “equities” of his position should appeal to the Court with equal force in both cases. The Court’s admission that the policy favoring the security of business transactions demands that a corporation make good the reasonable expectations induced by its conduct is enough to prove the injustice of its whole ultra vires doctrine.

What has been said thus far is a criticism not of this case but of others in which the Court has failed to give effect to the policy which was here recognized. The only real objection to the decision is that the Court denied that it was relaxing its rule as to ultra vires contracts. In the principal case there was an express provision that no guaranty should be made unless two-thirds of the stock represented was voted in favor of such action. This is clearly a grant of authority upon a condition precedent and it
necessarily follows that until the condition is satisfied there is no authority. This being true, and it would certainly seem to be beyond question, it is difficult to see how the Court could say that even though the condition precedent had not been met, the corporation was nevertheless authorized to make the guaranty.

True, the Court was in a tight spot. Only the year before in *Pearce v. Madison R. R. Co.* it had firmly established its doctrine that *ultra vires* contracts were void. Naturally, when presented with a case in which every instinct of justice demanded that the corporation be held, the Court would try, if possible, to reach that result without overruling its previous decision, and that is exactly what was done. It does not follow, however, that it reached that result without encroaching upon the principle of the former case. Although the Court may not have been in a position to admit it at the time, certainly there is no reason why in looking back over the cases as a whole it should not frankly be recognized that in this case the Court really started a new line of decisions in which validity was given to unauthorized corporate action.

The holding in this case has been consistently followed. In *Louisville Ry. Co. v. Louisville Trust Co.* the position of the complaining stockholder was much more favorable than in the *Zabriskie* case where he had not acted with due diligence. In the *Louisville* case a statute provided that the directors might upon petition of a majority of the stockholders make a guaranty of the bonds of another road. The directors made such a guaranty without any petition and the stockholders repudiated this action at their next meeting. Some of the bonds held by the Trust Company had been purchased in good faith and some with notice that the guaranty was made without authority. The Court held that the guaranty was valid as to those purchased in good faith and void as to those taken with notice. But if the Court was correct in the *Zabriskie* case in saying that the guaranty was *intra vires*, query how notice would have anything to do with the rights of the bondholders. It would seem rather that the Court is admitting

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143 21 How. 441, 16 L. Ed. 184 (1858).
145 174 U. S. 552, 19 S. Ct. 817 (1899).
that the transaction was unauthorized and that as to one who has notice of the want of authority the policy in favor of the security of transactions is lacking.

Assuming the position to be sound that an act is truly \textit{ultra vires} when the conditions precedent upon which authority was granted have not been complied with, it is interesting to note how in this case the Court has disregarded the interests of non-assenting stockholders and the interest of the state in preventing unauthorized corporate action. These interests were subordinated to the interest in the security of business transactions when the bonds were purchased in good faith, and were given effect only when the latter interest was lacking due to the fact that the purchaser had notice of the "abuse of authority". Here again it is seen that the result reached by the Court has really been dictated by its judgment as to the relative importance of the various interests involved.

(2) Recovery in quasi-contracts.

The second main line of retreat from the Court's strict \textit{ultra vires} doctrine has been the granting of recovery in quasi-contracts even though no recovery can be had on the contract itself.

An excellent example of this is found in \textit{Pullman Co. v. Central Transportation Company}.\footnote{171 U. S. 138, 18 S. Ct. 808 (1898).} Before the Supreme Court rendered its decision that the lease was void, the Transportation Company had filed several suits for installments of rent due under the contract. In order to avoid further inconvenience the Pullman Company filed a bill for an injunction against the bringing of successive suits, offering to pay the Transportation Company any sums which might be found due up to the time that the Pullman Company elected to terminate the lease, which it claimed the right to do under the terms of the contract. Before this suit was concluded the Supreme Court handed down its decision that the lease was void, whereupon the Pullman Company applied for leave to dismiss its bill. This application was opposed by the Transportation Company which also moved for leave to file a cross bill for the recovery in quasi-contracts of the value of its property under the lease.

The Transportation Company based its claim to relief on the intimation contained in the closing paragraphs of the Supreme Court's opinion in the former case where it was said:
"... the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. ... 

"Whether this plaintiff could maintain any action against this defendant, in the nature of a quantum meruit, or otherwise, independently of the contract, need not be considered, because it is not presented by this record, and has not been argued."147

The cross bill was allowed and on appeal to the Supreme Court it was held that the Transportation Company was entitled to the value of the property at the time of the alleged election by the Pullman Company to terminate the lease, the Court taking the position that the property was held with the consent of the lessor so long as the rent was paid and that the implied promise to return it or pay for it did not arise until the repudiation of the lease by the lessee. Under this view it was held that the patents and contracts, all of which had expired during the fifteen years when the rent was paid, could not be taken into account and this despite the fact that the contracts had been renewed and that these contracts, as representing the "business" of the Transportation Company, were probably the main part of the consideration for the rent under the lease. The result was that the Pullman Company was made to account only for the rolling stock and other tangible property which was valued at slightly over $700,000. This sum was considerably less than the agreed rental for three years, and the lease was supposed to run 99 years.

Except to note that this failed miserably to do full justice to the Transportation Company and to note that similar result is often reached when recovery is allowed only in quasi-contracts, the measure of recovery will not be discussed further. Consider rather the reasons which the Court gave for allowing any recovery at all, and also whether the result reached really constitutes a repudiation of the Court's strict doctrine. The Court itself insisted that it was not:

"... in no way and through no channels, directly or indirectly, will the courts allow an action to be maintained for the recovery of property delivered under an illegal contract

147 139 U. S. 24, 60-61, 11 S. Ct. 478 (1891).
where, in order to maintain such recovery, it is necessary to have recourse to that contract. The right of recovery must rest upon a disaffirmance of the contract, and it is permitted only because of the desire of courts to do justice as far as possible to the party who has made payment or delivered property under a void agreement, and which in justice he ought to recover. But courts will not in such endeavor permit any recovery which will weaken the rule founded upon the principles of public policy already noticed.148

If the public policy is so strong as to demand that the contract be held illegal and void in the first instance, then certainly this policy is weakened by allowing any rights whatever to flow from the "illegal" transaction. As was said by the New York Court in Bath Gas Light Co. v. Claffy,

"... if the express contract was illegal in a proper sense, and the parties to the lease were guilty of a public wrong, so as to preclude a court of equity to entertain jurisdiction on the application of a lessor to be relieved from the lease and to be restored to the possession of the leased property, as was held in the case of The St. Louis ... Railroad Co. v. Terre Haute & I. Railroad Co. (145 U. S. 393), then surely it would be a mere evasion and would be inconsistent with legal principles for the court to imply a contract from the occupation under the illegal lease to relieve the wrongdoer from the dilemma into which he had voluntarily placed himself."

The Supreme Court has itself recognized that there can be no quasi-contractual recovery when the contract, in addition to being ultra vires, is truly illegal or in contravention of some strong public policy. In Awotin v. Atlas Exchange National Bank of Chicago,150 A purchased bonds from the bank upon its agreement at A's option to repurchase the bonds when they matured at par with accrued interest. This agreement was in violation of an express statutory provision that national banks could engage in the business of buying and selling securities only if the business was conducted "without recourse".151

Upon the bank's refusal to repurchase, A sought damages for breach of contract or recovery of his purchase price on quasi-contractual grounds. The Court, in holding that the contract

148 Supra n. 146, at 151-2.
149 151 N. Y. 24, 36, 45 N. E. 390 (1896).
151 Id. at 211.
was *ultra vires* and void and that *A* was entitled to no relief, said:

"The invalidity of the contract was not due to the mere absence of power in the bank to enter into it, in which case restitution, not inequitable to the bank or inimical to the public interest, might be compelled. . . . National banks are public institutions and the purpose and effect of the statute is to protect their depositors and stockholders and the public from the hazards of contingent liabilities . . . . The prohibition would be nullified and the evil sought to be avoided would persist, if, notwithstanding the illegality of the contract to repurchase, the buyer, upon tender of the bonds, could recover all that he had paid for them."

This line of reasoning should be compared with that in the *Central Transportation Company* case where quasi-contractual recovery was allowed. The result of such comparison is the conclusion that whenever the Court allows relief in quasi-contracts it necessarily admits that neither the policy against *ultra vires* contracts in general nor the policy against transfers by public service corporations is so strong as to make the transaction truly illegal. And this admission is certainly a repudiation of its doctrine that all *ultra vires* contracts are illegal and void.

It must be admitted that the argument just made is open to the objection that no account was taken of the fact that some of the transactions considered so far have been executed and some executory, and hence that even viewing them as truly illegal some reconcilement of the decisions can be made. This was purposely left out of account because it is clear that the Supreme Court rule allowing recovery in quasi-contracts is not based on the idea that so long as an illegal contract remains executory, the policy against such illegal action is furthered by allowing a recovery. That this is true becomes apparent from a consideration of other cases in which the rule has been applied.

In *Aldrich v. National Bank* it was held that even though the bank had no authority to borrow money, it was liable in an

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153 See *Spring Co. v. Knowlton*, 103 U. S. 49, 53, 26 L. Ed. 400 (1880).

154 176 U. S. 618, 20 S. Ct. 498 (1900).
action for money had and received to the extent of any sum actually used by it. The Court speaks of "common honesty" and of "equity and good conscience", and refers to the fact that there is nothing in the Acts of Congress which would authorize a national bank to use money or property of another for its benefit without liability for so doing. Again in Citizens' National Bank v. Appleton\textsuperscript{155} the Court says that "The law would be very impotent to do justice if it could not . . . without violating established legal principles" allow recovery of property received under an ultra vires contract. In that case A was indebted to the national bank to the extent of $10,000. It was arranged between A and the national bank that A should borrow $12,000 from another bank which loan the national bank was to guarantee, and that A should give the national bank $10,000 of the amount so obtained. The making of such a guaranty was ultra vires but the bank was held upon an implied promise to repay the $10,000 actually received by it.

It is apparent from these cases that the basis for the rule is broadly the equitable principle that one person should not be unjustly enriched at the expense of another, or more particularly the principle that whenever one person has received property from another which in good conscience he is not entitled to keep, the law will imply a promise to return it or its equivalent. If there is any policy which compels the Court to deny recovery on an ultra vires contract to repay money, that policy is certainly defeated when the Court turns right around and allows the money to be recovered on the basis of an implied contract. Of course the corporation should be made to pay, but the Court should recognize that in allowing recovery it is cutting the ground out from under its doctrine that ultra vires contracts are illegal and void. No amount of talk about reaching this result "without violating established legal principles" and about no recovery being allowed on the contract but only in disaffirmance of it can get around the fact that in reality the Court is giving validity to an ultra vires transaction. It has been constrained to do this because the injustice of the situation created by the application of its rule that ultra vires contracts are void was simply too much for the Court to stand.

That the Court itself realizes that in allowing recovery on an implied contract it has really been doing indirectly what it refused to do directly is quite apparent from a later decision. In *National Bank v. Mott Iron Works* the situation was strikingly similar to that in the *Appleton* case. A obtained a sub-contract for the plumbing in a hospital being built by B who agreed to pay monthly 85% of the value of the labor and materials furnished by A, the balance to be paid upon the completion of the work. A assigned this contract to the defendant bank as security for advances made to him. A later ordered supplies from the plaintiff who refused to ship them without some security. Thereupon, in order to enable A to complete his contract so that he could repay the advances, the bank executed a written guaranty to the plaintiff for the payment by A of a bill for over $2300. Subsequently the bank received $1100 under the assigned contract and would have received much more except for the fact that it allowed B to pay more than $5400 directly to A. As a result of this A still owed the bank a balance after he had been credited with the $1100 actually received. Under these circumstances the plaintiff sued the bank on its written guaranty and recovered judgment for the full amount in a state court. This recovery on the contract was affirmed by the Supreme Court.

In a very short opinion by Justice Holmes the Court said:

"Therefore the bank is in the position of having realized the benefit to acquire which the guaranty was made, and of having realized it out of the proceeds of the goods that it induced the Iron Company to sell.

"In such circumstances, whether the contract is valid or not, the contractor is accountable to the contractee, up to the amount of his undertaking, for the proceeds coming to his hands from the contractee upon the inducement of the contract. *Citizens' Central National Bank v. Appleton*, 216 U. S. 196. In this case therefore the plaintiff is entitled to recover the amount for which it has declared, and as the case was fully tried upon the merits, the distinction between a recovery on the guaranty, as having been necessarily incident to the business of banking, and a recovery of the amount received by petitioner on account of the guaranty, becomes purely formal.""
THE DOCTRINE OF ULTRA VIRES

It is to be regretted that the Court interpolated the comment about the guaranty being necessarily incident to the business of the bank, which might allow it later to distinguish this case on the ground that the guaranty was after all *intra vires*. However, it is seriously to be questioned whether the Court meant to intimate that such a guaranty by a national bank was *intra vires*. For this would be to overrule the holding in the *Appleton* case that a similar guaranty was unauthorized. In both cases the bank in order to collect a debt owing to it guaranteed the performance of a contract from the proceeds of which it hoped to realize the sum due it, and in the *Appleton* case it was taken for granted that such a guaranty by a national bank was *ultra vires*. This case will be considered, then, on the assumption that the guaranty here was also *ultra vires*.

To begin with, the Court admits that whether the contract is valid or not there is no substantial difference between a recovery on the guaranty and a recovery on an implied contract, which of course presupposes that the contract price was the same as the reasonable value of the goods. This is a clear recognition that in the application of its rule as to recovery in quasi-contracts the Court has been doing indirectly what it has refused to do directly, and that such a formal distinction as it had been making in the past would not warrant the reversal of a case which had been fairly tried on its merits. In view of the customary language of the Court in its former decisions the admission of such an evident fact is indeed surprising.

In the second place, although the Court purported to be applying the principle of the *Appleton* case in finding that the plaintiff was entitled to recover in quasi-contracts the full amount of the guaranty, it would seem that this case is really an extension of that principle. In the *Appleton* case the bank was held liable only for the $10,000 which actually came into its hands, although the plaintiff had paid out $12,000 on the faith of the guaranty. But in the instant case although the bank actually received only $1100 as proceeds of the contract assigned by the plaintiff, it was held liable for $2300, the full amount of the guaranty. True, the bank could under the assigned contract have received more than enough to cover the guaranty, but allowed the money to be paid directly to A. If the view be taken that such payments to A with the assent of the bank are to be regarded as in legal effect pay-
ments to the bank itself, which would certainly be true if the suit were by the bank to recover on the assigned contract, then it may be admitted that the case is no extension of the former principle except in so far as the reasonable value of the goods may have been less than the contract price, on which point there is no evidence either way. Though it was not made clear, it may well be that this is all the Court meant for it referred several times to the proceeds of the plaintiff's property which came into the hands of the bank. But however that may be, even if without any extension of the principle of the Appleton case the amount of recovery in quasi-contracts is properly the same as the sum recoverable on the guaranty, the fact remains that since here the Court recognized that there is only a formal difference between these methods of recovery, this case marks a substantial retreat from the Court's former position.

In the application of their strict doctrine, the English courts have been more logically consistent than the Supreme Court. They have recognized that to allow recovery in quasi-contracts is to defeat the policy which they feel demands that ultra vires contract be held void, and have consequently denied recovery in such case. The only relaxation of this rule has been in those cases where the ultra vires creditor could trace his money or property into assets remaining in the hands of the corporation. Further, if the creditor can prove that his money or property has been used to pay off intra vires obligations of the company, thus not increasing its indebtedness, he is allowed recovery on the theory that by tracing his property into the hands of the other creditor he is thereby subrogated to the claim which that creditor had against the company.

A leading English decision dealing with this problem is Sinclair v. Brougham.\(^{108}\) In that case, a company formed to operate as a building society went into the general banking business which was of course ultra vires. If the shareholders did not consent to this ultra vires undertaking in advance, they at least ratified it in so far as this was possible by their failure to raise any objection after learning all the facts. This unauthorized business became so large that the company had on deposit more than ten million pounds. Upon the liquidation of the company the question was the priority between creditors on intra vires transactions, the de-

\(^{108}\) (1914) A. C. 398.
THE DOCTRINE OF ULTRA VIRES

positors and the shareholders. It was held that the *intra vires* creditors should be paid in full and that the balance should be divided pro rata between the shareholders and the depositors, except in so far as some depositors might be allowed a preference on the theory of subrogation outlined above. The Court denied that there was any quasi-contractual obligation on the part of the company to repay the money given it by the depositors. The result was that the shareholders, who in effect had invited the deposits, were unjustly enriched at the expense of the depositors.

In the course of his opinion, Lord Haldane said:

"To hold that a remedy will lie in personam against a statutory society, which by hypothesis cannot in the case in question have become a debtor or entered into any contract for repayment, is to strike at the root of the doctrine of ultra vires as established in the jurisprudence of this country. That doctrine belongs to substantive law and is the outcome of statute, and cannot be made different by any choice of form in procedure.

"It is, therefore, binding both at law in equity."\(^{160}\)

This is indeed logically consistent and serves to bring more sharply into relief the inherent injustice of the whole line of reasoning underlying the strict *ultra vires* doctrine.

Despite this logical consistency in result, the statement that since a promise in fact would have been void there can therefore be no valid implied promise,\(^{160}\) overlooks the circumstance that the promise in quasi-contractual recovery is one implied in law and not one implied in fact. True enough, the implication in law of a promise to repay would be logically inconsistent with the conception based on the Fiction Theory that a corporation is legally incapable of incurring any obligation in connection with an unauthorized transaction. But to imply the promise in this case and thus to confer legal capacity on the corporation at least to this extent, is no more illogical than to confer legal capacity in the case of a tort under cover of the doctrine of *respondeat superior*, which the English courts have long since done.

Turning again to the Supreme Court decisions, it would seem to be evident that the granting of recovery in quasi-contracts is, so far as it goes, a repudiation of the Court’s strict doctrine of

\(^{159}\) *Id.* at 414.

\(^{160}\) *Id.* at 417, 433, 440.
ultra vires and is hence a step in the right direction. But as has already been pointed out, the result reached when recovery is limited to quasi-contracts is often unfair to the plaintiff whether he be the one who dealt with the corporation or the corporation itself. This is true because he normally loses the benefit of his bargain which the policy favoring the security of transactions demands that he receive. Since the Court by granting quasi-contractual has already come so near to enforcing the ultra vires contract, and has thus admitted the weakness of the reasons for its strict rule, it ought now to go the whole way and declare such a contract valid unless there is some policy involved which can be adequately protected only by holding the contract void or unless there are circumstances present by reason of which the policy in favor of the security of business transactions is lacking. This would certainly come nearer to doing justice as between the parties, which after all should be the goal of the law in every case.

E. The Treatment of Purely Executory Contracts — Specific Performance

In treating all ultra vires contracts as void the Supreme Court has not made the distinctions normally taken in the state courts between contracts wholly executed, those executed on one side, and those wholly executory. However, the results reached are much the same as if the distinctions had been made.

When the contract has been wholly executed the transaction is not subject to collateral attack, in a majority of state courts on the ground that such performance validates the contract, and in the Supreme Court on the ground that the law will leave the parties to an illegal transaction where it finds them. When the contract has been executed on one side only the general rule in the state courts is that recovery will be allowed because such performance makes the contract valid, and the Supreme Court allows recovery in such case in quasi-contracts. However, although it comes within the principle of the Appleton case, query whether the Supreme Court would allow recovery where the defendant has received no actual property which he should return to the plaintiff but where he has received valuable services. While the Supreme Court has not passed on this point, a lower federal court has held that in order to prevent unjust enrichment recovery
would be allowed in such case.\textsuperscript{161} When the contract is wholly executory the majority rule in the state courts is in accord with the Supreme Court rule that no recovery will be allowed. And it is probably the universal rule that no specific performance can be had of a wholly executory \textit{ultra vires} contract.\textsuperscript{162}

Before taking up the Supreme Court cases in which the matter of specific performance was involved, consider the single case found in which a state court without the aid of a statute has held that a wholly executory \textit{ultra vires} contract was valid and enforceable. In \textit{Harris v. Independence Gas Co.}\textsuperscript{163} the owners of land had made a lease of the gas and oil rights to a corporation. Subsequently the owners purported to convey the oil rights to the plaintiff who then brought an action against the corporation to cancel that part of the lease relating to those rights on the ground that the corporation was not authorized to engage in the oil business. The Kansas court, treating the lease as an executory contract, denied this relief saying that it was "convinced of the soundness of the view that in the absence of special circumstances affecting the matter neither party to even an executory contract should be allowed to defeat its enforcement by the plea of \textit{ultra vires}. The doctrine is logical in theory, simple in application, and just in result."\textsuperscript{164}

In the course of the opinion it was said that while it is inaccurate to base the majority rule as to the enforceability of \textit{ultra vires} contracts executed on one side on the ground of estoppel, such use of the term estoppel is not misleading. However, it is likely to be misleading and it is certainly more conducive to clear thinking to place the rule squarely on the ground of "public policy" as was done in this case, provided that the policy involved be clearly defined.

It was next said that the problem of \textit{ultra vires} action by a \textit{de jure} corporation, where the question is whether the corporation has authority to enter into the particular transaction in dispute, can be assimilated to the problem of \textit{de facto} corporations where the question is whether the corporation has authority to enter into any transactions whatever. It was pointed out that the rule in both cases is based not upon the ground of estoppel but upon

\textsuperscript{161} Quicksilver Min. Co. v. Anderson, 245 Fed. 67 (1917).
\textsuperscript{162} See 7 \textit{FLETCHER, CYC. OF CORP.} § 3462.
\textsuperscript{163} 76 Kan. 750, 92 Pac. 1123 (1907).
\textsuperscript{164} \textit{Id.} at 763.
grounds of public policy. Although the intimation was made that completeness and logical symmetry would seem to require that any legal system which allows recovery on a partly executed *ultra vires* contract should also allow recovery on a purely executory contract, it was later said that the view that this question of performance was important is not unreasonable, there being at least a difference in degree in the merit of the claims made in the two cases.

These observations of the Kansas court raise some interesting questions. Consider for a moment the practice of making estoppel the basis of the majority state rule which allows recovery on contracts executed on one side, and inquire whether this rule is consistent with a refusal to allow recovery on a wholly executory contract.

As for the matter of estoppel, it is indeed possible to work out an estoppel against a corporation when it represents that it has authority to enter into a contract and the other party performs his side of it in reliance upon this representation. But even here the estoppel argument fails if the doctrine of constructive notice be applied, because then there could be no reasonable reliance. But when the other side of the picture is looked at, it is clear that the party who deals with the corporation makes no representation upon which the corporation can reasonably rely to its damage, the corporation being always chargeable with notice of its own lack of authority. At best all that can be said in favor of the corporation is that the other party has impliedly promised not to plead *ultra vires*. But no effort has been made to place the decisions on the ground of promissory estoppel and it is clear that all the courts which have allowed the corporation to recover in such case have not yet accepted that doctrine. And even if estoppel would satisfactorily explain the rule, query whether the measure of damages should be the contract price or only the reasonable value of the plaintiff’s performance. It would seem that on the theory of estoppel it should properly be the latter which is really the extent to which the plaintiff has been damaged by his reliance on the representation made.

It follows then that to justify any recovery by the corporation and certainly to justify its recovery of the contract price some explanation other than estoppel must be given. A satisfactory explanation can be found only in the principle that the policy favor-
THE DOCTRINE OF ULTRA VIRES

ing the security of transactions requires that one who has entered into a transaction make good the reasonable expectations induced by his conduct unless such a result would operate to defeat some countervailing policy of paramount importance. It has already been shown that no such policy exists in the case of a contract which is simply ultra vires.

In respect to the distinction generally made between partially executed and wholly executory contracts, it seems evident that regardless of the ground on which recovery is allowed when the contract has been executed on one side, the result is logically inconsistent with a denial of recovery when the contract is wholly executory. In the first place, the merit of the majority state rule as to contracts executed on one side over the rule allowing recovery only in quasi-contracts is that the majority rule gives the plaintiff the benefit of his bargain. It is indeed true that at first blush the position of one who has given the defendant the performance called for by the contract would seem to appeal more strongly to the court than the position of one who has furnished nothing and has merely an expectation of a profit. But when it is realized that this difference in position is equalized by the allowance of recovery in quasi-contracts, it at once becomes apparent that no justification can be made for giving the plaintiff the benefit of his bargain in the one situation that does not apply with equal force to the other. And when it is further realized that the proper and only satisfactory explanation of recovery on the contract is any case is the policy favoring the security of transactions, it necessarily follows that the rule as to executory contracts should logically be the same as the rule regarding contracts executed on one side.

This being so obviously true, and the rule allowing recovery on a purely executory ultra vires contract being in the language of the court in the Harris case so "logical in theory, simple in application and just in result", it is indeed surprising that no courts without the aid of a statute have followed the decision in that case in the twenty-seven years since it was handed down.

Returning now to the Supreme Court cases, consider those in which the matter of specific performance was involved. In Pennsylvania R. R. Co. v. St. Louis R. R. Co.\textsuperscript{165} the lessor brought suit for the specific performance of a lease. The Court took the

\textsuperscript{165} 118 U. S. 290, 6 S. Ct. 1094 (1886).
position that under the circumstances the bill would be granted if the contract was *intra vires*, but upon a consideration of the corporation's authority found that the contract was *ultra vires* and hence that no relief could be given. And so, although this is a direct holding that the Supreme Court will not grant specific performance of an *ultra vires* contract, it is unsatisfactory for present purposes in that it fails to discuss the peculiar questions incident to the problem of the specific performance of such a contract, which questions can arise only when the transaction is valid at law.

However, in *Case v. Kelly* 106 which involved an *ultra vires* acquisition of property the Court made its position on this matter clear though the question of specific performance was not directly involved. In that case donors of land to a railroad corporation conveyed it to individual officers of the company upon a secret trust for it, the corporation already having all the land it was authorized to own. In an action by the receiver of the corporation to have the trust declared and to compel a conveyance of the property to the corporation, it was alleged that the officers acted fraudulently in taking conveyance to themselves when they should have had the land conveyed directly to the corporation. But the Court denied any relief, saying that:

"... while a court might hesitate to declare the title to lands received already, and in the possession and ownership of the company, void on the principle that they had no authority to take such lands, it is very clear that it will not make itself the active agent in behalf of the company in violating the law and enabling the company to do that which the law forbids."107

This is essentially the same as the argument generally made in denying specific performance of an *ultra vires* contract — that a court of equity will not affirmatively assist a corporation to do an unauthorized act. Two reasons are usually assigned as the basis for this argument. One is that the granting of specific performance would defeat the policy of the law against unauthorized corporate action. But when it is remembered that the problem of specific performance cannot properly arise unless the contract is enforceable at law, it becomes apparent that this argument of policy is answered by the fact that the policy will be defeated

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106 133 U. S. 21, 10 S. Ct. 216 (1890).
107 Id. at 28. For a dictum to the same effect, see U. S. v. No. Pac. R. R. Co., 152 U. S. 284, 300, 14 S. Ct. 598 (1894).
in any event by the recovery at law of damages for breach of the contract. Thus, in so far as this question of policy is concerned, it seems that logically a court of equity should grant specific performance in any case where the contract would be enforceable at law, provided of course the remedy at law is inadequate. And this result has been reached by some courts both in actions by the corporation and in actions by the other party in cases where the contract had been partly performed.\(^{168}\)

The other reason given for the refusal to grant specific performance is that it would be futile to do so because the state could at once declare the charter forfeited or oust the corporation from the *ultra vires* business. As a practical matter this is answered by the fact that the state seldom takes any action against the corporation. But it must be admitted that there is a residuum of force in this argument of futility because there is always a chance, however remote it may be, that the state will proceed against the corporation in *quo warranto*, and this bare possibility may be enough to warrant a denial of specific performance when the contract is wholly executory. But it must be kept in mind that the admission that conceivably the refusal of specific performance may be justified in some cases is not an admission that the plaintiff is entitled to no relief. On the contrary, as was mentioned above the problem of specific performance does not properly arise unless the case is one in which there is a remedy at law.

That only injustice can result from a denial of any relief whatever has already been argued and is brought out pointedly in *Case v. Kelly*, the Supreme Court decision under consideration. Although the question of the specific performance of a contract was not directly involved, the situation was very analogous. Admitting for the moment that the Supreme Court was justified in refusing to compel the officers to convey the land to the corporation, its refusal to declare them constructive trustees of the land and to make them account for its value is indefensible. The result was that while the creditors of the corporation were denied this means of collecting their claims, the fraudulent fiduciaries were left in possession of property to which in good conscience they were not entitled. While the Court intimates that possibly

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\(^{168}\) Coleridge Creamery Co. v. Jenkins, 66 Neb. 129, 92 N. W. 123 (1902) (action by corporation — decision rendered by Pound); Dorsett v. Traction Co., 30 S. D. 420, 138 N. W. 808 (1912) (action by other party).
the donors of the land might object, it says very clearly that neither the corporation nor the receiver could complain.

It is true that the corporation had not furnished any consideration for the land other than the building of its road. But the statement that a court of equity will not affirmatively assist a corporation by declaring a trust of lands which it was not authorized to take is broad enough to deny relief even if the corporation had paid for the land. This refusal at least to compel an accounting merely illustrates the injustice inherent in the Court’s strict doctrine.

With that case compare Schuyler National Bank v. Gadsden\(^{10}\) where in order to avoid the prohibition against the taking of real estate security by a national bank, the mortgage was made to an officer of the bank in trust for it. Although the matter was only incidental, all parties admitting that the bank could have the benefit of the security, the Court said that ‘‘the taking of real estate security by the president of the bank in his individual name, for the benefit of the bank, was in legal effect but the taking of security by the bank itself.’’\(^{110}\) This is sound enough but it is difficult to see why in the other case the conveyance of land to the officers in trust for the corporation was not also in legal effect a conveyance to the corporation.

True, the cases can be distinguished on the ground that in the bank case the Court was merely applying the well established equitable principle that the security follows the debt, that no matter to whom the mortgage was given, if it was intended to secure a certain debt, the owner of that debt can have the benefit of the security. But in the other case if the Court had applied the equally well established equitable principle that a fraudulent fiduciary must be compelled to account to his beneficiary, the result would have been a recognition of the equitable title of the corporation. This would have been enough to bring the case within the general rule that an \textit{ultra vires} acquisition of property can be questioned only by the state, for surely that rule is not limited to the acquisition of legal title alone.

In a situation like that in \textit{Case v. Kelly} neither the donors of the land nor the fraudulent officers as grantees should be allowed to take advantage of the fortuitous circumstance that the convey-

\(^{10}\) 191 U. S. 451, 24 S. Ct. 129 (1903).
\(^{110}\) \textit{Id.} at 468.
ance was not made directly to the corporation, in which case the transaction would admittedly have been open to no collateral attack. The injustice of the Court's refusal to declare the trust in this case is accentuated by the fact that under the circumstances the real beneficiaries would have been the creditors of the corporation and not the corporation itself. It is evident that the Court here failed to make a proper evaluation of the interests involved.

It is realized that to urge the adoption of the view that an executory *ultra vires* contract is valid and in addition to urge that specific performance of such a contract be granted whenever the remedy at law is inadequate, is to get considerably ahead of the game. But when the state and federal cases are viewed as a whole, beginning with those which hold that a corporation can do nothing which was unauthorized and hence is not even liable for torts or crimes, and coming on down to the *Harris* case and to those few cases where specific performance was granted, it becomes evident that in the development of our law as to *ultra vires* transactions there has been a definite and sustained trend toward the view urged. And it is believed that the matter will be handled satisfactorily only when the courts go all the way and hold such transactions subject only to direct attack by the state unless in a given case there is some policy involved which outweighs the policy in favor of the security of transactions or unless this latter policy is lacking due to the fact that the party dealing with the corporation has actual notice of the want of authority.

VI. MISCELLANEOUS CASES

There remains for consideration a varied assortment of cases which could not without inconvenience have been taken up under the groupings so far made.

A. Ultra Vires By-Laws

In *National Bank v. Insurance Company*\(^{172}\) the charter of the bank expressly authorized the directors to make a by-law prohibiting the transfer of stock owned by any stockholder who was indebted to the bank unless such transfer was made with the consent of the directors. In pursuance of this authority such a by-law was passed in which it was declared that the bank should have a lien on the stock for any sum owing by the stockholder and

\(^{172}\) 193 U. S. 581, 24 S. Ct. 524 (1904).
this by-law was copied in and made a condition of the stock certificates. Under these circumstances the bank advanced money to one of its stockholders, it being mentioned at the time that the stock was to be part of the security but no pledge of the certificate being made. Subsequently the stockholder pledged the certificate with the insurance company as collateral. Upon default on the second loan the stock was sold at auction and was purchased by the insurance company which then demanded that the bank transfer the stock on the books. The bank refused to do this on the basis of its by-laws of which the insurance company had notice by reason of the condition in the stock certificate. In an action to compel the bank to make the transfer the Supreme Court held that despite the express authority in the charter such a by-law was void because it was ultra vires and also against the policy in favor of the free alienation of property.

The correctness of this holding becomes apparent upon a consideration of these additional facts. The bank had been organized under the Banking Act of 1864 which had expressly repealed the Act of 1863. The Act of 1863 had itself prohibited transfers by stockholders who were indebted to the bank. Since this provision was left out of the Act of 1864 there is an implied prohibition against any further restrictions on alienation and hence a prohibition against the making of such a by-law as the one in question. And since any part of a charter which is in conflict with a provision of the statute under which the corporation was formed is void, the by-law was therefore unauthorized and invalid. The Court found in the express repeal of the former provision a legislative policy favoring the free alienability of stock in national banks,¹⁷² which is really but a part of the larger policy of the law favoring the free alienability of property in general.

Of course, the decision in this case is eminently sound. Certainly a corporation cannot claim authority under provisions in its charter which are in conflict with either the letter or the spirit of the statute under which it was organized, particularly when such charter provisions may so easily be overlooked by the official whose business it is to record the incorporation papers. There being no special interest favoring the validity of ultra vires by-laws, they are generally held void.¹⁷³

¹⁷² See also Bank v. Lanier, 11 Wall. 369, 20 L. Ed. 172 (1870); Ballard v. Bank, 18 Wall. 589, 21 L. Ed. 923 (1873).
¹⁷³ Ballantine, Private Corporations § 178, at 596-601.
THE DOCTRINE OF ULTRA VIRES

B. The Compromise of an Ultra Viros Transaction

In Market Company v. Kelly, a corporation chartered for only twenty years built a market house on land owned by it in fee and made a 99-year lease of one of the stalls to the defendant. The defendant in part payment for this lease gave the corporation twenty notes payable over a period of years. Subsequently in compromise of the transaction the defendant gave the corporation another note for a sum smaller than the total of the original notes. The compromise note remaining unpaid at maturity, the corporation brought suit upon it. The defendant claimed that both the original transaction and the compromise were void on the ground that since the corporation was chartered for only twenty years it did not have the authority to make a lease for a longer period, to which the plaintiff replied that a corporation regardless of the time for which it was chartered could hold and transfer a fee and consequently could make a valid conveyance of any estate less than a fee. This argument of the plaintiff was unquestionably valid and was enough to dispose of the case, but the Court refused to pass on that point and placed its decision on the validity of the compromise, saying that even "If the plaintiff had exceeded its corporate powers in making the original contract, yet it had authority to compromise and settle all claims by or against it under that contract. . . . The compromise of the disputed claim on the original notes was a legal and sufficient consideration for the new note."

Although only one more Supreme Court case was found involving the matter of the compromise of an ultra vires transaction, the decision that such a compromise is valid is sound enough and is simply another method by which the Court gets around its strict doctrine. For it should be noted that the result reached is but another way of saying than an ultra vires contract is not truly illegal. It is probably the universal rule that a compromise of an illegal transaction is open to the same objections that could have been directed at the original transaction. Consequently, to hold that whatever policy exists against ultra vires contracts can be defeated by a compromise is to admit that the

174 133 U. S. 199, 5 S. Ct. 422 (1885).
175 Id. at 202.
176 Gas Co. v. Berry, 113 U. S. 392, 5 S. Ct. 525 (1885) (compromise held valid, but query whether the transaction was ultra vires in the proper sense).
177 2 Williston, Contracts (1931) § 1784 and cases there cited.
policy is decidedly weak. Further, it is interesting to note that no account was here taken of the interests of the stockholders or of the rule about constructive notice. So this case must be added to the already long list of cases in which the Court has swung away from its doctrine that *ultra vires* contracts are illegal and void.

C. Who may Question an *Ultra Vires* Transaction

It is of course true that the state which chartered the corporation may proceed against it for usurpation of authority and even if the state did not grant the charter, it may question the corporation’s authority to transact business within the state\(^{178}\) except in so far as this power may be subject to constitutional limitations. And under proper circumstances a non-assenting stockholder may raise the point. Further and unfortunately the Supreme Court allows both the corporation and the other party to take advantage of the lack of authority in many cases, particularly those dealing with *ultra vires* contracts.

On the other hand, however, in *Railroad Co. v. Ellerman*\(^{179}\) the court held that the authority of the corporation could not be questioned by a third party who had not dealt with the corporation in connection with the *ultra vires* business even though he may have been injured by the competition afforded by that business. The Court said that if he could not have complained of the same competition on the part of an individual, he may not complain merely on the ground that the business was beyond the authority of the corporation, which question can be raised only by an interested party. The result here reached is in accord with the rule generally followed that a stranger may not collaterally attack an *ultra vires* transaction unless it is expressly so provided by statute.\(^{180}\)

D. Application of State Law by Federal Courts

The question whether the federal courts are bound to apply state law is quite a problem in itself and will be considered here only in so far as a stand has been taken on it in regard to the doctrine of *ultra vires*. There are surprisingly few cases either in the Supreme Court or in the lower federal courts in which the


\(^{179}\) 105 U. S. 166, 173-174, 26 L. Ed. 1015 (1881).

\(^{180}\) *FLETCHER, CYC. OF CORP.* §§ 3448 and 3451.
THE DOCTRINE OF ULTRA VIRES

question has been discussed. As a matter of general practice it would seem that all parties concerned have taken it for granted that the federal courts would apply their own rule without regard to the contrary state rules. Otherwise it would be impossible to account for the small number of cases in which the question has been raised or for the great difference in the way in which the doctrine of ultra vires has developed in the federal courts and in the state courts as applied to corporations chartered by the states. Of course, the federal doctrine is to be followed when the corporation is one organized under an Act of Congress.181

It is stated in FLETCHER ON CORPORATIONS182 that the Supreme Court seems never to have decided whether it is bound to follow the state rule. And while the matter has been discussed in a few cases, it is indeed difficult to say just what the Court's position is, for even those few decisions are by no means consistent.

In considering this matter it should be borne in mind that there are two distinct problems, one of minor importance concerning the duty to follow state decisions on the question whether the transaction was ultra vires or not, and the other of prime importance concerning the duty to follow state decisions on the question of the legal effect of an ultra vires transaction.

Before taking up these questions it may be well to distinguish two other groups of cases in which the problem though somewhat similar is quite distinct. On the one hand, there are cases in which the highest court of a state has passed on the question of the effect of an ultra vires transaction by a corporation formed in the state. In these cases it is clear that the decision of the state court in the particular case is binding on the Supreme Court both as to whether the transaction was ultra vires and as to the effect of the transaction if ultra vires, the decision on these points raising no federal question.183 On the other hand, there are cases originating in the courts of another state in which the question on appeal to the Supreme Court is whether full faith and credit has been given to the laws of the state where the corporation was organized. In these cases the decisions of the state which chartered the corporation are to be given effect both as to whether the transaction was authorized and as to the effect of unauthorized action, provided

182 7 Fletcher, Cyc. of Corp. § 3482.
of course they have been proved as matters of fact in the trial court.\(^\text{184}\)

The cases under immediate discussion are those which originated in or were removed to a federal court and which raise the question of the extent to which the federal court is bound to apply state law when dealing with a corporation formed in that state. On the first problem as to whether the transaction was *ultra vires*, there seems to be no doubt that the federal court is under a duty to follow any authoritative decisions of the state courts construing either a statute of the state or the charters of corporations formed under the statute.\(^\text{185}\) But when this point is passed and the question arises as to the effect of an *ultra vires* transaction, it is unsafe to generalize. About all that can be done is to point out the inconsistent positions which have been taken by the federal courts on this question.

Consider first the Supreme Court decisions. In *Sioux City Terminal Co. v. Trust Co.*\(^\text{186}\) the question was the validity of a mortgage given to secure an issue of bonds. The corporation claimed that the mortgage was void because the debt secured by it was in excess of a statutory debt limit. The Supreme Court upheld the mortgage saying that it was bound by decisions of the state court that such contracts were enforceable. In *Williams v. Gaylord*\(^\text{187}\) the Court held a similar mortgage void, again saying that it was bound by state decisions to that effect. So far this would seem to be in line with the general rule that the construction and effect of a state statute are to be determined by the law of the state.

But with those cases compare *Ward of Joslin*\(^\text{188}\) which was decided on the same day as the *Gaylord* case. In the *Joslin* case the question as to the effect of an *ultra vires* transaction arose in an unusual and interesting manner. In a previous suit in a state court in Kansas the plaintiff had procured a default judgment against a corporation on an *ultra vires* guaranty but he was able

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\(^{187}\) 186 U. S. 157, 22 S. Ct. 798 (1902).

\(^{188}\) 186 U. S. 142, 22 S. Ct. 807 (1902).
to obtain only a partial satisfaction of that judgment. He then brought suit in a federal court against the defendant, a stockholder, to enjoin the defendant's secondary liability under the statutes and Constitution of Kansas which provided that stockholders should be liable to the extent of the par value of their stock for the debts of the corporation. The Supreme Court held that the defendant could go behind the judgment in the prior suit to show that it had been rendered on an *ultra vires* contract and further to show that the liability of a corporation on *ultra vires* transaction was not a debt of the corporation within the meaning of the statutes and Constitution of Kansas as properly construed.

It was admitted that the rule in Kansas as to *ultra vires* contracts was a liberal one, but because a case exactly like the one in question had not been passed on, the Court purported to conclude that if the corporation had put in the defense of *ultra vires*, the Kansas Court would have sustained it. But very properly the Court was not satisfied with that line of reasoning, so it went further and said:

"If, however, under the state decisions, the corporation would be held estopped from denying the liability, it does not follow that the stockholders must therefore be held liable, if the obligation was in fact incurred without authority."¹⁸⁹

Then on the assumption that "debts" as used in the Kansas Constitution was so ambiguous a term as to justify the Court in putting its own construction on it, there being no Kansas decision on the point, the Court proceeded to read into the constitutional provision the qualification that "debts" means only those obligations incurred in an *intra vires* transaction. It would seem obvious that debts as here used can only mean such obligations as are enforceable in the courts of this state. The fact that there were no state decisions in which the question had been raised is fair evidence that the term is void of ambiguity.

But even if the Court may have a technical justification for its interpretation, the result is certainly out of harmony with the admittedly liberal doctrine of the Kansas Court. The case can be explained only on the assumption that even when the Supreme Court purports to apply state law it will give effect to its own doctrine whenever it disagrees strongly enough with the result which would follow a logical application of the state rule. This is

¹⁸⁹ *Id.* at 151.
borne out by the emphasis which the Court placed on the fact that one of the most important grounds of the doctrine of ultra vires is the protection of stockholders. While this may be true of the federal doctrine, it most assuredly was not true of the Kansas rule which the Court was supposed to be applying.

Despite the decisions in the first two cases, when consideration is taken of the attitude of the Court in the Joslin case and of the many other cases in which the federal rule has been applied without regard to the state decisions, it would be unsafe to say that the Court has adopted any settled policy on the question of what law is controlling. The decisions cannot be reconciled on the principle that in some of them the question was the construction and effect of a state statute in which case the Court is bound by the state decisions, while in others it was one of general jurisprudence in which case the Court is free to apply its own view. In all of the cases the statute is merely read into and becomes a part of the charter so that ultimately the question involved is the effect of the violation of its charter by a corporation. And the fact that there were often opposing state decisions construing an applicable statute in those cases where the Court applied its own rule is hard to reconcile with the Court's statement that it will take judicial notice of those decisions.190

The confusion on this subject is very naturally carried over into the decisions of the lower federal courts. For instance, in Lumber Co. v. Goldman,191 where state decisions on the effect of an ultra vires contract were followed, it was said:

"The rule that one who has received the benefit of a contract which is simply ultra vires and not contrary to good morals may not plead the defense of ultra vires is fully sustained by the decisions of the Supreme Court of Arkansas, of which state the Lumber Company was a corporation. ... The law in this respect as announced by the Supreme Court of Arkansas is to be followed by us."

On the other hand, however, consider Lewis v. National Bank,192 where although it was admitted that the federal court was bound by a state decision that a contract was ultra vires, it was said:

190 R. R. Co. v. Ferry Co., 119 U. S. 615, 622, 7 S. Ct. 393 (1887).
192 274 Fed. 587, 595 (1921).
"The rights and remedies of the parties to this ultra vires contract are questions of general jurisprudence, and therefore the decision in that respect is not controlling, but must be decided by this court upon the facts in this case."

In view of this evident lack of any settled federal court policy in regard to the matter of following state law, little hope for an early escape from the *ultra vires* doctrine of the Supreme Court is evident along this line.

It is undoubtedly true that as a general proposition it is desirable for the federal courts to be free to apply their own rules on matters of general jurisprudence without regard to the anomalies of the local law, for in this way the cause of uniformity is furthered. However, when the federal rule is the decided minority view, this matter of uniformity really becomes an argument for imposing on the federal courts a duty to follow state law, or at least an argument for a change in the federal rule.

**VII. Recent Developments**

**A. Lower Federal Court Decisions**

There have been very few Supreme Court cases dealing with *ultra vires* transactions since the passage of the Judiciary Act of March 3, 1911, 195 which made final the judgment of the Circuit Court of Appeals in most of those cases in which the problem would normally arise, leaving an appeal to the Supreme Court open only by means of a writ of *certiorari*, the granting of which is discretionary. In view of this fact an examination was made of the decisions of the lower federal courts in order to determine the extent to which the Supreme Court doctrine has been followed or modified. This examination was largely limited to cases involving *ultra vires* contracts, for it is in this field that the Supreme Court rule is most out of accord with the rule in the majority of state courts. A review of only a few of these decisions will suffice to show that by and large little advance, if any, has been made beyond the Supreme Court position.

Many of the cases state and apply the strict doctrine that no recovery can be had on the contract under any circumstances, recovery being limited to quasi-contracts. For example, in *Texas and

195 §§ 128, 239, 240 and 251.
Pac. Ry. Co. v. Potterff\textsuperscript{104} it was held that a national bank was not bound by its ultra vires contract to secure a private deposit and that it was entitled to liberty bonds pledged with its trust officer for that purpose, the depositor being left to his claim with other general creditors. And again in Coon v. Smith\textsuperscript{105} a contract by a national bank to repurchase securities at the selling price, which was above the market price, was held void but recovery of exactly the same amount as would have been due on the contract was allowed on a count for money had and received. Although both these cases involve a national bank, the court does not emphasize this fact but discusses the matter generally and states its doctrine so broadly as to apply to state corporations as well. And the same strict doctrine is stated in cases involving state corporations. For instance, in Gibson v. Kansas City Refining Co.\textsuperscript{106} although the case was brought within the exception as to the abuse of authority, the court lays down the strict view.

On the other hand, there are quite a few cases allowing recovery on the contract itself when the corporation has received the benefit of the contract. For example, in Kellogg-Mackay Co. v. Havre Hotel Co.\textsuperscript{107} the corporation was held liable on an ultra vires guaranty, having received the benefit of the goods furnished under it. But if it be assumed that the benefit conferred is equal to the contract price, there is no advance over the position taken by the Supreme Court in the Mott Iron Works case. And that the rule as thus applied in some of the lower federal courts is really based on principles of quasi-contracts is borne out by the

\textsuperscript{104} 63 F. (2d) 1 (1933), aff'd 291 U. S. 245, 54 S. Ct. 416 (1934). Accord, City of Marion, Ill. v. Sneeden, 291 U. S. 262, 54 S. Ct. 421 (1934) (companion case). The same rule was followed by the District Court of the Northern District of West Virginia in Harrell v. Lawhead, 13 F. Supp. 298.

\textsuperscript{105} 4 F. Supp. 960 (1933). But see Avotin v. Atlas Exchange Nat. Bank of Chicago, 295 U. S. 209, 55 S. Ct. 674 (1935), discussed supra p. 308, where the Supreme Court held such a transaction wholly void, giving rise neither to a right on the contract nor to a right of quasi-contractual recovery.


decision in In re Steele Furniture Co.\textsuperscript{198} There the Court said that the corporation would be estopped to plead \textit{ultra vires} when sued on the contract if the benefit of the performance went to it, but the defense was allowed because no benefit was received.

In view of these cases which are a fair cross section of the lower federal court decisions since 1911, it would be unsafe to say that there has been much further liberalization of the accepted federal doctrine. While the court failed to mention it, probably some of these more liberal decisions may be explained on the ground that the court was merely applying the state rule to a state corporation. But aside from that, since emphasis was placed on the benefit received under the contract, there is little difference between this result and allowing recovery only in quasi-contracts. At most, all that can be said is that a few of the lower federal courts have gone so far as to give the plaintiff the benefit of his bargain when the contract has been performed on one side.

\textbf{B. Statutory Modifications of the Ultra Vires Doctrine}

As long ago as 1898 it was prophesied "that we shall never see our commercial law in a satisfactory state until the courts re-establish the common law doctrine of general capacities, treating contracts made beyond the limits of the charter activity as contracts prohibited but not void and leaving the state to punish the disregard of the prohibition while enforcing the contract between the parties."\textsuperscript{199}

While there has been some movement in this direction, the prophecy has on the whole come true. As has been seen, only one state has gone so far as to allow recovery on a purely executory contract, most of the states having been content with the allowance of recovery on a contract executed on one side. The uncertainty as to when recovery was to be allowed and the lack of agreement as to the ground on which recovery was to be placed have resulted in confusion on the whole subject generally and also in confusion in the decisions of a single court, as witness the state of affairs in the Supreme Court cases.\textsuperscript{200} The courts having failed to remedy this confusing situation, as was sooner or later to have been ex-

\textsuperscript{198} 18 F. (2d) 490, 491 (1927), cert. denied 274 U. S. 758, 47 S. Ct. 758 (1927).
\textsuperscript{199} Pepper, \textit{Unauthorized Corporate Contracts} (1898) 8 \textit{Yale L. J.} 24, 31.
\textsuperscript{200} And cf. Stevens, \textit{Ultra Vires Transactions under the New Ohio General Corporation Act} (1930) 4 U. of Cin. L. \textit{Rev.} 419, where a similar confusion in the previous Ohio decisions is pointed out.
pected the legislatures have recently begun to take a hand in the matter with the avowed purpose of "obviating a disgraceful legal situation which had no basis in history, came into the law by mistake, and remained to plague businessmen and lawyers for nearly a hundred years." 201

Following the example of Vermont202 which has had legislation on the subject since 1915, the legislatures of ten other states — Ohio203 in 1927, Louisiana204 in 1928, California,205 Idaho206 and Indiana207 in 1929, Michigan208 in 1931, Illinois,209 Minnesota,210 Pennsylvania,211 and Washington212 in 1933, — have passed statutes either entirely abolishing or drastically limiting the doctrine of ultra vires in so far as the parties to the transaction are concerned. Without entering upon a detailed consideration of these various statutes, a field which has recently been more than adequately covered213 and one which is somewhat foreign to a consideration of the Supreme Court decisions, two points may profitably be made in connection with this newly awakened legislative interest in the subject.

In the first place, this recent legislative activity is proof of the fact that the problem of ultra vires is by no means a dead issue and that the present unsatisfactory state of the law has resulted in a growing demand for change. It would seem that the persistent refusal of the Supreme Court in the past twenty-five years to take under review more than a few cases involving ultra vires transactions, and this presumably on the ground that the matter was not of sufficient importance to warrant the granting of a writ of certiorari, is but another way of saying that in the opinion of the Court its doctrine as formulated in the last century is a satisfactory solution of the problem. However, when in contrast to this

201 Report of Special Committee on Revision of Ohio Corporation Law (1926) 59.
202 VT. GEN. LAWS (1917) §§ 4919, 4923; Vt. Laws 1915, No. 141, § 15.
204 LA. LAWS 1928, No. 250, § 12.
205 CAL. CIV. CODE (Deering, 1923) § 355 as amended by Cal. Laws 1929, c. 711, § 25.
206 Idaho Laws 1929, c. 262, § 10.
207 IND. ACTS 1929, c. 215, § 3.
210 § 2 MINN. STAT. (Mason, Supp. 1934) § 7492-11.
213 See Note (1930) 44 HARV. L. REV. 280 and other articles there cited; 7 FLETCHER, CYC. OF CORP. §§ 3439-3440.
complacent attitude of the Supreme Court one notes the dissatisfaction of businessmen and laymen generally with even the liberal state rules, which dissatisfaction has already assumed sufficient proportions to compel legislative action in seven states, it becomes fairly evident that this subject is one of enough importance to require the Supreme Court to reconsider its present doctrine and so modify it as to bring it into accord with the demands of present conditions and so into accord with the demands of justice.

And in the second place, it is at least open to question whether the problem can be better solved by legislation than by the courts in their lawmaking capacity. In a recent note in the Harvard Law Review\(^{214}\) it was pointed out that the Uniform Business Corporation Act, the provisions of which in regard to *ultra vires* were substantially adopted in several states is so general in its distinction between capacity and authority, in its conferring upon corporations the capacity of natural persons and in its abolition of the doctrine of constructive notice of the limitations on the authority of the corporation, that the Act can have the desired effect only if given a liberal and sympathetic interpretation by the courts. On the other hand, it was suggested that the statutes which go further and with certain exceptions in favor of the state and non-assenting stockholders specifically abolish the doctrine as in California, or abolish it except in the case of actual notice of the lack of authority as in Ohio, are subject to the danger of omission inherent in all codification and are also open to the possible objection that the attempt to spell out exactly the consequences of unauthorized action will result in too rigid a scheme.

Whether these objections are more than theoretical, it is too early to say but it does seem that a problem which involves the conflicting interests of the state, the corporation, its creditors, its stockholders and third parties is one which naturally lends itself more readily to judicial than to legislative treatment. And it is certainly true that the success or failure of these statutes in removing the existent inconsistency and injustice will ultimately depend upon the attitude of the courts in applying them.

This being so, the courts should and may with credit to themselves proceed to make over their rules on this subject. There can be no valid objection to such action on their part. Indeed, it would be a serious indictment of the law should the courts admit their

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\(^{214}\) (1930) 44 Harv. L. Rev. 280.
inability to remove the objectionable features of this doctrine which under present conditions is so unsuited to a just treatment of the problem. However, if the courts should continue their refusal to correct this unfortunate situation, there is at least in the case of the state courts a reasonably good prospect that the legislatures will soon take the matter in hand. But little hope can be seen along this line in respect to the Supreme Court doctrine for there are comparatively so few federal corporations that an attempt by Congress to remedy the situation could at best be but a partial success. It necessarily follows, then, that in the light of the growing demand for change the Supreme Court will in the future be open to even more serious criticism than in the past if it persists in its refusal to reconsider its outworn and unjust doctrine.

VIII. Conclusion

It has been seen that almost from the beginning two conceptions of the nature of a corporation have been in constant competition as starting points for judicial reasoning on the subject of ultra vires corporate action. Although the conception at first adopted was the one formulated in the Fiction Theory with the result that corporations were held responsible for no unauthorized action whatever, almost at once there became apparent a definite and sustained trend toward the adoption of that conception which is embodied in the Realist Theory. And while for a time this constant advance toward the Realist Theory was to be seen in the Supreme Court decisions, in recent years this progress has unfortunately come to an end.

The first swing away from the Fiction Theory was in those cases holding the corporation liable for crimes and torts, the Court realizing that in no other way could protection be given to the social interest in the general security and to individual interests of personality and substance. There soon followed a line of cases holding ultra vires acquisitions of property valid, this result being dictated by the necessity for the protection of the social interest in the security of acquisitions. And although the Supreme Court has refused to give validity to ultra vires contracts as such, there again under pressure of the interest in the security of business transactions it has been compelled to give effect to them indirectly either under cover of the exception as to an abuse of authority or by allowing recovery in quasi-contracts.
THE DOCTRINE OF ULTRA VIRES

This was all very well so far as it went but when one considers the immature stage at which this progress was arrested, the outlook is anything but promising. From whatever point of view the matter is approached, there seems to be no justification for the present position of the Supreme Court.

Its doctrine falls far short of the ideal of a body of logically interdependent precepts. Such logical consistency can be attained only by the exclusive application of either the Fiction Theory or the Realist Theory and is certainly not to be hoped for when the Court applies now one, now the other. It is apparent that the Supreme Court has failed to keep pace with the majority of American courts in the progressive development of the idea of corporate liability for all unauthorized action. It is also clear that the doctrine is inadequate to even a theoretically just and equitable solution of the problem.

When in dealing with ultra vires contracts the Court attempted a logical development of the Fiction Theory, it laid itself liable to all the criticism which can be directed against the mechanical application of legal rules. In singling out for protection the interests of non-assenting stockholders and the interest of the state that corporations keep within their authority, the Court caused an untold and unnecessary waste of other interests which should normally be protected by the policy in favor of the security of transactions. But still more serious has been the Court's failure to reconsider its doctrine in the light of present conditions and thus to take account of the growing and insistent demand for a more practical solution. It is only natural that a doctrine formulated under conditions which existed a century or more ago when corporations were comparatively few and unimportant should be impracticable under present conditions when the bulk of business activity is carried on by means of the corporate device. It becomes a serious matter indeed when the courts fail to realize and to guard against the results of this necessary obsolescence of legal doctrines.

As was said before, no entirely satisfactory and just solution of this problem of ultra vires may be expected from the Supreme Court until it so modifies its present doctrine as to make unauthorized corporate action subject only to direct attack by the state unless the case is one involving some paramount interest which can be adequately secured only by holding the transaction void or
unless special circumstances are present which negative the existence of the social interest in the security of transactions. It is to be hoped that the Supreme Court will no longer stand out against a view which is demanded alike by logical analysis, by historical development, by considerations of right and justice, and above all by the ever pressing necessity that traditional legal materials must be constantly reshaped in the light of existent conditions if they are to be made subservient to the needs of the present.