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The Doctrine of Ultra Vires in United States Supreme Court Decisions

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The doctrine of ultra vires corporate action has always raised serious and disturbing problems. The difficulty of dealing with the question is greatly increased by the inconsistency and confusion found in the cases on the subject. This confusion is serious enough when one considers only the state decisions in general or even those of a single state, but it becomes acute when attention is turned to the decisions of the United States Supreme Court.

To begin with, the language of the Supreme Court is hopelessly contradictory. If this were the extent of the contradiction, the matter would not be a serious one. Unfortunately, however, even if what the Court has said be disregarded and attention paid solely to what it has done, the results cannot all be reconciled. It is indeed true that the cases fall into some semblance of order when emphasis is placed on the result reached by the Court rather than on its reasoning. It becomes at once apparent that from the beginning there have been two conceptions of the nature of a corporation which were in constant competition as possible starting points for the Court's reasoning. And further, it is apparent that there has been a definite trend away from the stricter conception which the Court at first adopted, toward a more liberal one.

The Court's original conception of the nature of a corporation was founded on the Fiction Theory. According to this theory a corporation is not a reality but is a mere creature of the law.

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Hence it has no existence apart from the law; it lacks the capacity to do any act not authorized by the state and its personality is but a legal fiction. In contrast to the Fiction Theory is the so-called Realist Theory. According to this theory, a corporation is a reality entirely apart from the law with a social or *de facto* personality quite distinct from the legal personality conferred upon it by the state. Hence it has the capacity to do many things which the state has not authorized it to do.2 No sooner had the Supreme Court adopted the Fiction Theory as the starting point for its reasoning in matters of corporation law than it was found that the logical application of this theory would in many situations lead to most undesirable results. As a consequence, almost from the beginning there has been evident a definite trend on the part of the Court toward the adoption of the Realist Theory.

It is to be regretted that the Court has in general thought it necessary to disguise its growing tendency to accept the Realist Theory. This being true, however, in a study of the cases as a whole in order to see just how far this trend has gone, one must be interested primarily in what the Court has done and only incidentally concerned with what was said. But on the other hand, in view of the fact that there has been a constant reiteration of the Fiction Theory, often in cases which are in effect a repudiation of it, one should not wholly disregard the language of the Court, for it is clear that the lip service paid the old doctrine has seriously hindered and at times almost stopped the trend away from it.

Due in large part to the confusion resulting from the Court's effort to cover up what was going on, several independent and apparently inconsistent lines of decision have grown up and still exist side by side. This paper is an examination of the origin and development of these distinct lines of decision in an effort to discover on the one hand the extent to which they are truly contradictory, and on the other the extent to which they may be fitted into a logically consistent scheme. In addition, certain features of the way in which the Supreme Court has handled the whole matter of *ultra vires* transactions will be contrasted to the treatment given the problem in some of the state courts.

In a study of the Supreme Court decisions, one should keep constantly in mind that there have been two conceptions of the

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2 For a more detailed examination of the Fiction and Realist Theories, see Colson, *Corporate Personality* (1936) 24 Geo. L. J. 638.
nature of a corporation which have played most important parts as competing starting points for the Court’s reasoning. A review of the specific considerations which have for the most part determined the Court’s choice between these competing conceptions will be left until the cases are examined in detail. Suffice it now to say that this choice has turned largely upon a weighing of the individual and social interests involved, but whether this weighing was done consciously or not does not always appear.  

I. Definition of Ultra Vires

Unfortunately the term “ultra vires” has been used by the courts in more than one sense. This renders necessary a statement of the sense in which it is here used. Literally, an ultra vires corporate act is an act beyond the powers of the corporation. But if by “power” is meant “capacity”, then by hypothesis there can be no such thing as an ultra vires act. The use of the term as meaning “beyond the capacity of the corporation” has contributed much to the conclusion that an ultra vires act is void. In its proper sense an ultra vires act is simply an act which the corporation does without authority from the state for so doing.

Thus defined, the term is broad enough to include transactions which are illegal in the true sense of the word. There are some who favor a more restricted definition of ultra vires. For example Machen says:

“In its proper sense, it denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined by the statutes under which it is formed or which are applicable to it, or by its charter or incorporation paper.”

This definition is quoted with approval by Stevens who goes on to say:

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3 It is apparent to one familiar with Dean Pound’s Theory of Social Interests that this approach is not in the least original. The writer has merely attempted to deal with the question of ultra vires in the light of that theory, with particular emphasis on the problem of the proper evaluation of the social interests involved. See Pound, Outlines of Lectures on Jurisprudence (4th ed. 1928) 60-71 and authorities there cited.

4 2 Machen, Modern Law of Corporations (1908) 819.
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"... by its very terms, it excludes the quality of illegality from the act in question, and makes the want of authority to do the act the sole objection to it." 5

The objection made to the use of the broader definition is that it is conducive to the error which some courts have made of treating all ultra vires transactions as illegal. It is certainly true that this error should be avoided and that a court should realize the distinction between an act which is both ultra vires and illegal and one which is ultra vires only. In order to do this, however, it is not necessary to place narrow qualifications on the definition of ultra vires. Aside from the fact that such qualifications add greatly to the length of the definition, too much refinement is likely to cause more difficulty in a subject already difficult enough.

It would seem better to use ultra vires in the broader and simpler sense of all transactions not authorized by the state, in contrast to intra vires transactions which are authorized. Ultra vires or unauthorized transactions may then be classified as (1) acts which are not only ultra vires but are also crimes, (2) acts which are not only ultra vires but are also torts, (3) acts not only ultra vires but also illegal or against public policy, and (4) acts which are simply ultra vires but are otherwise unobjectionable. A conception of ultra vires as including all these will be conducive to clearer thinking on the problem and consequently will promote a more satisfactory solution of it. With such conception in mind, a court which had already given recovery in the case of corporate torts which are clearly unauthorized would have been less likely to deny recovery in the case of an unauthorized contract. However much the solutions may differ depending on the circumstances, there is the common problem in all these cases as to the effect to be given unauthorized corporate action.

Harno has suggested that the subject of ultra vires would be clarified by the adoption of the Hohfeldian concepts of privilege and power. 6 This seems to be doubtful. True it is that corporate acts are intra vires when done pursuant to the exercise of a power which is also a privilege. And similarly those acts done pursuant to the exercise of a legal power which is not a privilege are ultra vires. The difficulty is that you can never tell whether there is a legal power until the court has passed on the question. If the

court decides that the transaction is void and hence that it gives rise to no legal relations between the parties, then and then only can it be said that the corporation had no legal power. On the other hand it cannot be said that the corporation had the legal power until the court has held that the transaction gave rise to legal relations. For instance, in commenting on the strict rule as to statutory companies in England, Harno says:

"Under this view, which appears to treat ultra vires acts as mere nullities, it will be observed that the corporation has neither the power nor the privilege to engage in such transactions. It does not have the privilege because the ultra vires acts are outside of the express or implied privileges conferred, and it has not the power because any effort to create a legal relation of this nature is futile."

However helpful Hohfeld's concepts may be in classifying decisions after they have been rendered, they are of doubtful assistance before the fact. The whole question is whether the court shall give legal validity to the ultra vires act. Here again it would seem desirable to keep the problem as free from overrefinement as possible. Certainly the subject of ultra vires is difficult enough without further complicating it with Hohfeldian concepts, the adequate comprehension of which is something of a problem in itself.

Some courts have classed as ultra vires those acts which have been done by the directors or other officers of a corporation in excess of their authority, though within the authority of the corporation. In such a case the problem is simply one of agency. It should be treated as such and kept separate from the question of ultra vires.\(^7\)

It should be noted that the definition of an ultra vires act as one done without the authority of the state for so doing is broad enough to include an act done in abuse of a general power or without compliance with certain conditions precedent. The classification of such an act as ultra vires has been criticized by some who argue that we should distinguish between the abuse of authority and the entire lack of authority.\(^8\) However, as Ballantine has said, "whether such a distinction as this is sound admits

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\(^7\) Id. at 22-23.


\(^7\) FLETCHER, CYC. OF CORP. § 3402.
of a very reasonable doubt.\textsuperscript{10} Logically it would seem that if a corporation has been given authority to borrow money for one purpose and it borrows for a different purpose, there is just as much a lack of authority to enter into the particular transaction as there would have been had the corporation had no authority to borrow for any purpose. In each case the corporation has acted beyond the authority conferred upon it by the state.

It may well be that there are stronger reasons for holding the corporation liable on the contract in the one case than in the other, but this does not mean that one of the acts is \textit{ultra vires} and the other not.\textsuperscript{11} It is easy to see how a court which has already established the rule of no liability for an \textit{ultra vires} contract might well be forced to make such a distinction in order to reach a desired result without overruling its previous decision. However, such distinctions only serve further to confuse the problem. It would seem better to recognize frankly that this is just another case in which the courts have given validity to an \textit{ultra vires} transaction and that they have done so in order to reach a result which the situation seemed to demand.

The question is quite analogous to the case of a principal's liability for the acts of his agent beyond the scope of his actual authority but within his apparent authority. Certainly it would not be conducive to clear thinking on that problem to say that because we hold the principal liable, the agent has not exceeded his authority. The truth of the matter is that the liability was imposed in both instances because the courts have felt that there was a social interest demanding such result.

For the purposes of this discussion, then, an \textit{ultra vires} act is any act done by the corporation without authority from the state for so doing. This simple and all inclusive use of the term makes the problem easier to grasp. By adopting it we avoid many overrefined distinctions which after all are of doubtful value. But in addition to this, it emphasizes the idea that the question is essentially the same whether the \textit{ultra vires} act be a crime, a tort, an abuse of authority or simply \textit{ultra vires}. Such a conception of the problem will tend to produce a more desirable solution.

\section*{II. Early Cases}

Before taking up the several distinct lines of decisions in the Supreme Court cases let us consider some of the early decisions

\begin{footnotesize}
\textsuperscript{10} \textit{Ballantine, Private Corporations} (1927) § 78, at 276.
\textsuperscript{11} For further discussion, see \textit{infra} V.-D-(1).
\end{footnotesize}
in which are to be found the roots of the strict federal rule on
ultra vires.

The first case dealing with the matter is Head & Armory v.
Providence Insurance Co. which was decided in 1804. Although
the phrase "ultra vires" had not been coined at that time, the doc-
trine of ultra vires is stated in its strictest form as clearly as may
be. The fact that in this case the Supreme Court definitely com-
mitted itself to the Fiction Theory makes it worth while to con-
consider it in some detail.

In a suit by Head & Armory on an insurance policy it be-
came necessary to determine whether the parties had rescinded the
contract before notice of the loss. The defendant corporation in-
roduced correspondence which it was claimed proved the con-
tact to cancel. The plaintiff contended among other things that
because one of the letters essential to the contract to cancel
was not signed and sealed by the corporation in compliance with
the charter requirements, it was not the act of the corporation and
consequently that the policy was still in force. The plaintiff's
contention was sustained by the Supreme Court.

In discussing this point Chief Justice Marshall said:

"'Without ascribing to this body, which, in its corporate
capacity, is the mere creature of the act to which it owes its
existence, all the qualities and disabilities annexed by the com-
mon law to ancient institutions of this sort, it may correctly
be said to be precisely what the incorporating act has made
it, to derive all its powers from that act, and to be capable of
exerting its faculties only in the manner which that act author-
izes.

"'To this source of its being, then, we must recur to as-
certain its powers, and to determine whether it can complete
a contract by such communications as are in this record.'" 13

Again, in contrasting the natural capacity of a human being with
the capacity of a corporation, he said:

"'He who authorizes another to make a writing for him,
makes it himself; but with these bodies which have only a legal
existence, it is otherwise. The act of incorporation is to them
an enabling act; it gives them all the power they possess; it
enables them to contract, and when it prescribes to them a
mode of contracting, they must observe that mode, or the in-
strument no more creates a contract than if the body had never
been incorporated.'" 14

12 2 Cranch 127, 2 L. Ed. 229 (1804).
13 Id. at 166-167.
14 Id. at 168.
And again, "It is a general rule that a corporation can only act in the manner prescribed by law."16 Of course he necessarily concluded that "an act not performed according to the requisites of the law cannot be considered as the act of the company, . . . ."10

The opinion has been quoted at this length in order to show the extent to which the Supreme Court in this case formulated its strict doctrine of ultra vires. The statement of it is no clearer in the Central Transportation Co. case17 which is usually taken to be the leading case on this subject. There is here a definite holding that any act beyond the authority conferred upon the corporation by the state is not the act of the corporation — in other words, that an ultra vires act is void.

The case is also of interest because in argument counsel for the corporation pressed upon the Court even at this early date the more liberal view as to corporate capacity. It was urged that the Court recognize the difference between the business corporation with which it had to deal and the ecclesiastical corporations with which the law was dealing when the strict rules were first laid down. Thus, it was said:

"The doctrine that a corporation cannot act but by its seal, may answer for the transactions of bishops, deans and chapters, abbots and monks, but, according to modern decisions, does not apply to mercantile corporations and mercantile transactions. . . . The bank of England, the East India company, and similar corporations may, by an agent, make promissory notes, draw and accept bills of exchange, and make all kinds of contracts and promises, like natural persons."18

It should be noted that this is essentially an argument that the social policy in favor of the facilitation of business intercourse demands a recognition of the general capacity of corporations.

This case is important because in it the Court adopted the Fiction Theory as the starting point for its reasoning on the problem of ultra vires, and not because of its actual holding that a seal was necessary. On the latter point it was soon held in Bank of the United States v. Dandridge that not even a writing was necessary as proof of the acceptance of a contract.19 In that case

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16 Id. at 165.
17 Id. at 167.
19 Supra n. 12, at 155.
20 12 Wheat. 64, 6 L. Ed. 552 (1827).
Justice Story cited the former case with approval and then proceeded to show that it was inapplicable. Chief Justice Marshall was not satisfied with that showing and said in his dissenting opinion:

"Though this general principle, that the assent of a corporation can appear only by its seal, has been in part overruled, yet it has been overruled so far only as respects the seal. The corporate character remains what Blackstone states it to be. The reasons he assigns for requiring their seal as the evidence of their acts, are drawn from the nature of corporations, and must always exist. . . . The declaration that a seal is indispensable, is equally a declaration of the necessity of writing; . . . ." 21

Logically Marshall was correct. He realized that the Court was departing from the strict conception of corporate capacity adopted in the former case. On the other hand, Justice Story's opinion illustrates the way in which the Supreme Court has refused to follow out logically all the implications of the Fiction Theory whenever to do so would defeat some interest which was felt to be paramount. It also illustrates the Court's practice of paying lip service to the older conception even when repudiating it.

In all the cases which have limited the strict doctrine of ultra vires as laid down in the first case will be found the recognition of some interest which the Court has thought was controlling. In this case it was realized by a majority of the Court that the exigencies of the orderly conduct of business by corporations demanded that they be allowed to contract with the same lack of formality as individuals. Hence a modification of the original doctrine, thus giving effect to the social interest in favor of the facilitation of business intercourse. That this is really the process which the Court was following is borne out by the concluding statement in Marshall's dissenting opinion:

"I have stated the view which was taken by the Circuit Court. . . . I have only to add, that the law is now settled otherwise, perhaps to the advancement of public convenience. I acquiesce, as I ought, in the decision . . . . though I could not concur in it." 22

Other early cases in which the strict doctrine of ultra vires is

20 Id. at 68.
21 Id. at 93.
22 Id. at 116.
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laid down may be noted briefly. Marshall's classic statement of the Fiction Theory is found in the Dartmouth College case:

"A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it. . . ."23

In Gossler v. The Corporation of Georgetown the issue was the validity of an ordinance of a municipal corporation changing the grade of a street. It was argued that the first ordinance fixing the grade amounted to a contract between the city and anyone who should build on the street. In holding that the corporation had no power to make such a contract, Marshall again said that "A Corporation can make such contracts only as are allowed by the acts of incorporation."24 In Beaty v. Lessee of Knowler25 the question was the validity of a sale of land to collect a tax levied by a private corporation. In holding the sale void because the corporation had no power to levy the tax for the purpose for which it was levied, the Court said:

"That a corporation is strictly limited to the exercise of those powers, which are specifically conferred on it, will not be denied."26

In the Georgetown case the Court recognized the desirability of leaving a municipal corporation free to exercise its governmental functions. In the Beaty case it affirmed the undesirability of giving effect to an unauthorized exercise by a private corporation of a power which "trenches on the common right" as does the power of taxation. It is in such cases as these, where the Court decides that upon a weighing of all the interests involved the result obtainable on the basis of the Fiction Theory is more desirable, that the federal doctrine of ultra vires is stated in its strictest form. But in addition to this there has been a tendency to repeat the doctrine by way of dictum and this repetition has had an unfortunate cumulative effect, contributing in no small way to the obstinacy with which the doctrine has hung on. An excellent example of this repetition by way of dictum is found in Bank of Augusta v. Earle where although the contract was held intra vires, Chief Justice Taney said:

25 4 Pet. 152, 7 L. Ed. 813 (1830).
26 Id. at 168.
"And it may be safely assumed that a corporation can make no contracts, and do no acts . . . except such as are authorized by its charter. . . . And if the law creating a corporation, does not . . . give it the right to exercise its powers beyond the limits of the state, all contracts made by it in other states would be void."\(^{27}\)

However, if what the Court has done rather than what it has said be kept in mind, it will be seen that despite the constant reiteration of the original narrow view many serious inroads have been made upon it. Admittedly this process has not always been a conscious one, though as will be seen it was obviously so in many instances. Indeed, two circumstances which have contributed to the longevity of the strict federal rule are the fact that the process was often an unconscious and blundering one and the further fact that even when the Court was aware of what it was doing, it usually made an effort to keep the process more or less under cover. With these considerations in mind let us proceed to an examination of the distinct lines of decisions found in the Supreme Court cases.

### III. Crimes and Torts

#### A. In General

The first lines of decisions to be considered are those dealing with corporate crimes and torts. The same objections were at first made against corporate liability for crimes and torts as have since been made against corporate liability for other *ultra vires* action.\(^{28}\) However, the law is now so well settled that a corporation is liable for its crimes and torts that no effort has been made to collect all the Supreme Court cases dealing with this matter. The consideration of only a few will be sufficient to show that the Court’s approach here is the same as in cases dealing with other *ultra vires* action.

Take first the matter of corporate liability for crimes. In *New York Central R. R. v. United States*\(^^{29}\) the corporation was indicted for giving rebates to shippers in violation of the Elkins Act. The Court referred to the earlier doctrine that a corporation is incapable of committing a crime and then, as representative of the modern view, quoted Bishop to the effect that:

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\(^{27}\) 13 Pet. 519, 587-588, 10 L. Ed. 274 (1839).


\(^{29}\) 212 U. S. 481, 29 S. Ct. 304 (1909).
"If . . . . the invisible, intangible essence of air, which we term a corporation, can level mountains, fill up valleys, lay down iron tracks, and run railroad cars on them, it can intend to do it, and can act therein as well viciously as virtuously?"30

The Court then went on to say:

"We see no valid objection in law, and every reason in public policy, why the corporation which profits by the transaction . . . . shall be held punishable by fine. . . . While the law should have regard to the rights of all, and to those of corporations no less than to those of individuals, it cannot shut its eyes to the fact that the great majority of business transactions in modern times are conducted through these bodies, and particularly that interstate commerce is almost entirely in their hands, and to give them immunity from all punishment because of the old and exploded doctrine that a corporation cannot commit a crime would virtually take away the only means of effectually controlling the subject-matter and correcting the abuses aimed at."31

This same line of reasoning is to be found in the cases dealing with corporate torts. In a comparatively early case in which a corporation was held liable for a negligent injury the point as to the incapacity of a corporation to commit a tort does not seem to have been raised.32 Very soon after this decision, however, it was pressed most strongly upon the Court in a case involving the question of corporate liability for libel.33 It was argued for the defendant that a corporation is a mere creature of the law, not given by the state the capacity to entertain malice, and hence that the libel could not be the act of the corporation but was only the act of the natural persons who published it. A group of cases was then referred to "showing that the corporation is not bound by acts of directors, when such acts are ultra vires."34 It is interesting to note that this is the first instance found of the use of the expression "ultra vires" in the Supreme Court Reports. The Court had no particular difficulty in meeting the defendant's argument.

30 Id. at 492-493.
31 Id. at 495-496.
32 Phila. & Reading R. R. Co. v. Derby, 14 How. 468, 14 L. Ed. 502 (1852).
34 Id. at 203.
"To support this argument, we should be required to concede that a corporate body could only act within the limits and according to the faculties determined by the act of incorporation, and therefore that no crime or offense can be imputed to it. . . . But this conclusion would be entirely inconsistent with the legislation and jurisprudence of the States of the Union relative to these artificial persons. . . . The result of the cases is, that for acts done by the agents of a corporation, either in contractu or in delicto, in the course of its business, and of their employment, the corporation is responsible, as an individual is responsible under similar circumstances.\textsuperscript{225}

Here again the Court has made a decided step away from its older conception of corporations, while continuing to refer to them as "artificial persons" or "mere legal entities, which exist only in contemplation of the law."\textsuperscript{226} As is often the case, the advance which the Court made is more apparent in the dissenting opinion than in the majority opinion. Justice Daniel says in his dissent that:

". . . from the definitions of corporations aggregate, as given by Brooke, Coke, and Blackstone, and by the express language of this tribunal in the earlier cases decided by it, these bodies are regarded as merely artificial — a species of \textit{fictiones juris}, created for particular objects, and vested certainly with no greater or higher attributes than the creator of those bodies has power to bestow. Man can have no power to confer mind, passion, or moral powers, upon a mere fabrication of his own — a mere piece of parchment or paper. No \textit{quo animo}, therefore, can be affirmed of a fiction to which no \textit{animus}, or passion, or moral quality, can be imparted.\textsuperscript{227}

When it is noted that Justice Daniel was entirely correct in saying that his view was the logical outcome of the Fiction Theory which the Court at first adopted, it becomes apparent how far the Court has retreated from its original position.

\textbf{B. Torts in Connection with an Ultra Vires Transaction}

The Supreme Court has also held that a corporation is liable for torts committed in connection with an \textit{ultra vires} transaction. There is a good dictum to this effect in \textit{National Bank v. Graham}.\textsuperscript{228} In that case the plaintiff had given the bank some bonds for safekeeping and they had been lost through the negligence of the bank.

\textsuperscript{225} \textit{Id.} at 209-210.

\textsuperscript{226} \textit{Id.} at 210.

\textsuperscript{227} \textit{Id.} at 220.

\textsuperscript{228} 100 U. S. 699, 701-702, 25 L. Ed. 750 (1879).
When sued, the bank put in the defense that the taking of special deposits by it was *ultra vires* and that consequently it was not liable. The Court held the transaction *intra vires* but in its discussion of the case said that even if this were not so, the defense of *ultra vires* would be inapplicable. In *National Bank v. Townsend* the bank purchased some bonds from the plaintiff under an agreement to resell them to him at the same or at a smaller price. When sued for its refusal to carry out the contract, the bank denied any liability on the ground that the agreement was *ultra vires*. The court held that assuming the transaction to be *ultra vires*, the bank was nevertheless liable for conversion of the bonds because of its failure to deliver them upon demand — that it could not repudiate the contract and at the same time retain the property which it had received under it. Similarly, in *National Bank v. Anderson,* where the bank was sued for the conversion of some notes which the owner had authorized it to sell to a third party and which the bank had itself purchased, the bank was held liable even though its agreement to sell the notes as agent of the owner was *ultra vires*. A case more directly in point is *Chesapeake & Ohio Ry. Co. v. Howard.* The company claimed that it was not liable in a tort action for personal injuries because its operation of the road where the injury occurred was *ultra vires*, but the Court nevertheless allowed recovery.

The considerations which led the Court to hold a corporation liable for crimes and torts whether in connection with an *intra vires* or an *ultra vires* transaction are well stated in *Salt Lake City v. Hollister.* That decision does not properly belong in this group of cases but it is so anomalous that it may as well be taken up here as elsewhere. *Salt Lake City* had been engaged in the *ultra vires* manufacture of liquor and having under protest paid taxes to the collector of internal revenue, it sued to recover the sum so paid. It was alleged that because the manufacture of liquor was *ultra vires*, the manufacture was not the act of the city but was only the act of its officers or agents and that therefore the city was not

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39 139 U. S. 67, 74, 11 S. Ct. 496 (1891). And cf. Nat. Bank v. Petrie, 189 U. S. 423, 425, 23 S. Ct. 512 (1903), where rescission of an *ultra vires* contract induced by fraud was allowed on the basis that the fraud was a tort antedating the contract and that hence relief could be granted on this ground without having recourse to the "void" contract.
42 118 U. S. 256, 6 S. Ct. 1055 (1886).
subject to the tax. In holding this argument unsound the Court said:

"The truth is, that, with the great increase in corporations in very recent times, and in their extension to nearly all the business transactions of life, it has been found necessary to hold them responsible for acts not strictly within their corporate powers, but done in their corporate name, and by corporation officers who were competent to exercise all the corporate powers. When such acts are not founded on contract, but are arbitrary exercises of power in the nature of torts, or are quasi-criminal, the corporation may be held to a pecuniary responsibility for them to the party injured."\(^{43}\)

It is interesting to note that the Supreme Court has taken this liberal position in respect to torts in connection with an \textit{ultra vires} transaction, for this problem still remains one of considerable importance in England which has always been a stronghold of the strict doctrine of \textit{ultra vires}. Professor Warren in a comparatively recent article argues for corporate liability in such case.\(^{44}\) Professor Goodhart in reply argues that a corporation is logically incapable of committing a tort in an \textit{ultra vires} transaction and that under the authority of \textit{Ashbury Ry. Carriage Co. v. Riche}\(^{45}\) an English Court would be bound so to hold.\(^{46}\) He thus recognizes the essential similarity of the problems of \textit{ultra vires} torts and \textit{ultra vires} contracts — that they are both part of the larger problem of \textit{ultra vires} transactions in general. But he fails to see that the problem is also the same in the case of an ordinary corporate tort. He attempts to distinguish the two on the ground that corporate liability for torts is based on the doctrine of \textit{respondeat superior},\(^{47}\) but he gives no satisfactory answer to the objection that this necessarily assumes that the corporation is legally capable of committing a tort. The law can never make a principal legally responsible for an act which the principal was legally incapable of performing. By definition, the very act of holding the corporation liable is a concession to it of the legal capacity to commit a tort which is certainly an unauthorized and therefore an \textit{ultra vires} act.

In dealing with corporate crimes and with torts in connection

\(^{43}\) Id. at 260-261.
\(^{45}\) (1875) \textit{L. R.} 7 \textit{H. L.} 653.
\(^{47}\) Id. at 360.
with both *intra vires* and *ultra vires* transactions the Supreme Court has recognized that the only satisfactory solution was the imposition of corporate liability. In the case of crimes it was seen that the legislative policy or the general policy of the law against such corporate action would be practically nullified unless the corporation were held responsible. And in the case of torts it was seen that the social interest in the protection of the plaintiff both in his interests of personality and of substance would in effect be defeated if the plaintiff were left solely to his remedy against the individuals responsible for his injury. Consequently, when upon a consideration of the various interests involved the Court concluded that the corporation should be held liable, it did not hesitate to modify its original conception of a corporation so as to allow that result. And it is especially to the credit of the Court that it has taken the most advanced position in regard to torts in connection with *ultra vires* transactions.

In all these cases we have seen a steady retreat from the Fiction Theory toward the adoption of that concept of a corporation embodied in the Realist Theory, and the reason for this steady progress has unquestionably been a recognition by the Court that in no other way could important social interests be protected.

IV. *Ultra Viros* Acquisitions of Property

A. In General

This line of cases, which definitely establishes the proposition that an *ultra vires* acquisition or transfer of property by a corporation can be attacked only by the state in a direct proceeding for that purpose, shows the recognition and protection by the Court of the policy favoring the security of acquisitions. This interest has long been looked upon as a paramount one and it is only natural to find that the Court early gave validity to those *ultra vires* transactions in which it was involved.

The earliest case in which this problem was considered is *Runyan v. Coster's Lessee.* [48] This was an action of ejectment brought by trustees who claimed title as trustees for a New York corporation to recover possession of land in Pennsylvania which had been purchased without the permission of that state. In view of the fact that the defendant introduced no evidence, it does not appear whether he was a mere stranger in possession or whether he claimed under the grantor. It seems rather surprising that

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the Supreme Court should have taken the position that the trustees acquired legal title under the deed of trust only if the corporation could itself have held the title. 49 It would seem more reasonable to say that they got the legal title in any event and that they held this title either in trust for the corporation or upon a resulting trust for the grantor and consequently that they could eject the defendant unless it was found that there was a resulting trust for the grantor and that the defendant claimed under him. But however that may be, the Court proceeded on the assumption that the title of the trustees depended upon whether or not the corporation could itself have taken title.

A statute of Pennsylvania provided that no corporation whether domestic or foreign could purchase land within the state without incurring a forfeiture of the land to the state unless the purchase was authorized by an act of the legislature, but the act further provided that the corporation could "hold and retain" the land subject only to being dispossessed and divested of title by the state. 50 In view of this statute the Court held that the corporation could hold the land subject only to forfeiture to the state and that consequently the corporation's authority to own the land could not be collaterally questioned by the defendant. It should be noted that though the statute in this case recognized that the corporation had power to hold the title it clearly denied its authority to do so without express legislative assent. Consequently, the case is a holding that an ultra vires acquisition of property by a corporation is valid except as against the state and it has been cited by the Court to this effect in cases in which there was no express statutory provision as to the consequence of such acquisition. 51 Although this holding is rather unsatisfactory because the title was in the trustees rather than in the corporation and also because of the statute involved, it has been the settled rule in the Supreme Court since this decision that ultra vires acquisitions of property are subject only to direct attack by the state.

In Vidal v. Girard's Executors, 52 decided only a few years later, the question was whether Philadelphia could take certain property left to it by devise. Although the Court held that the city had authority to take the property, there is a dictum broad

49 Id. at 129.
50 Id. at 130-131.
52 2 How. 127, 11 L. Ed. 205 (1844).
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enough to cover both municipal and private corporations to the effect that only the state can object to the corporation's incapacity to take.\textsuperscript{53} Similarly, in Myers v. Croft, where the Court held that there was a presumption that a land company has authority to own realty, there is also a dictum that the grantor and his privies could not raise this question in any event.\textsuperscript{64} The first really satisfactory holding on this problem is found in Cowell v. Colorado Springs Co.\textsuperscript{55} There the Court held that where a corporation was authorized to acquire such land as was necessary to carry on its business the question whether the particular land in dispute was necessary is a matter between the corporation and the state and is no concern of anyone else. The Court went on to say that great inconvenience and embarrassment would arise if titles were made to rest on proof of such necessity.\textsuperscript{66} Many subsequent cases have laid down the same rule either as a definite holding or by way of dictum.\textsuperscript{57}

Implicit in this rule is its corollary that even though the acquisition of the property was ultra vires, the corporation may nevertheless be a conduit of title. Probably the best case on this point is Kerfoot v. Farmers' & Merchants' Bank.\textsuperscript{58} In that case A conveyed land to the bank in trust for B, C and D, and the bank subsequently deeded the land to them. In an action by E, the heir of A, to set aside both deeds on the ground that the bank had no authority to hold land in trust the Court held that both deeds were valid. After stating the general rule as to ultra vires acquisitions of property, the Court said:

"This rule, while recognizing the authority of the Government to which the corporation is amenable, has the salutary effect of assuring the security of titles and of avoiding the injurious consequences which would otherwise result."\textsuperscript{59}

The Court does not often make such a frank admission that its doctrine of ultra vires is subject to considerations of policy.

\textsuperscript{53}Id. at 191.
\textsuperscript{54}13 Wall. 291, 295, 20 L. Ed. 562 (1871).
\textsuperscript{55}100 U. S. 55, 25 L. Ed. 547 (1879).
\textsuperscript{56}Id. at 60-61.
In line with the last case is Lantry v. Wallace\(^{60}\) in which it was held that an *ultra vires* purchase of its own stock by a national bank was not void but only voidable at the election of the government and that consequently the defendant who had purchased the stock from the bank could not escape liability as a stockholder on the ground that the bank through its *ultra vires* purchase acquired no title which it could convey to him. Although in most of the cases the property involved has been realty, this last case stands for the proposition that the general rule applies as well to personal as to real property.\(^{61}\)

Except for the case of Girard's Executors which contained only a dictum, all the transactions considered so far have been *inter vivos* and the American cases generally are in accord with the rule as developed in the Supreme Court. However, when the transfer is by devise or bequest there is a split of authority as to an *ultra vires* acquisition by a corporation.\(^{62}\) To begin with, if the statute of wills in a state does not allow devises to a corporation, of course the corporation takes no title because it is only by force of the statute that a devise can be made at all. The *ultra vires* problem arises only if the devise or bequest to a corporation is valid normally and is questioned only on the ground that the acquisition of the particular property was unauthorized. On this question the Supreme Court, in Jones v. Habersham,\(^{63}\) adopted the rule that just as in the case of acquisitions *inter vivos* the title vests in the corporation subject only to direct attack by the state. The contrary rule is represented by Cornell University v. Fiske\(^{64}\) in which it was said that a holding by a state court that the corporation takes no title in such a case raises no federal question and is binding on the Supreme Court.

Returning to *inter vivos* transactions, the question was presented in quite a different way in Smith v. Sheely.\(^{65}\) In that case A conveyed the land in dispute to B, a bank which though organized under an act of a territorial legislature was not authorized to transact business because its charter had never been approved by

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\(^{60}\) 182 U. S. 536, 552-553, 21 S. Ct. 878 (1901).

\(^{61}\) See also Miller v. King, 223 U. S. 505, 32 S. Ct. 243 (1912), where the acquisition by a bank of a judgment to be held in trust was found to be *intra vires*, but the Court intimates that even if it were *ultra vires* the question could not be raised collaterally.

\(^{62}\) For a more detailed discussion, see Ballantine, *Private Corporations*, § 85, at 287-290.

\(^{63}\) 107 U. S. 174, 188, 2 S. Ct. 336 (1882).

\(^{64}\) 136 U. S. 152, 174-175, 10 S. Ct. 775 (1890).

\(^{65}\) 12 Wall. 368, 20 L. Ed. 430 (1870).
Congress. B transferred the land to C and then subsequently A conveyed to D. In an action of ejectment by D against C, D offered to show B's incompetence to be a conduit of title. In affirming a judgment in favor of C, the court said admitting that the corporation was not authorized to purchase the land before its charter had been approved by Congress, it was nevertheless a *de facto* corporation and consequently neither the grantor nor his privies could question collaterally the capacity of the corporation to acquire the land which was entirely a matter between the corporation and the government.\(^6^5\)

This case is mentioned in order to point out that the problem as to the validity of the transactions of a *de facto* corporation is essentially the same as the problem of the validity of the *ultra vires* transactions of a *de jure* corporation. In the case of a *de jure* corporation only part of its transactions are *ultra vires*, whereas in the case of a *de facto* corporation all its transactions are unauthorized and hence are *ultra vires*. This being so, every case holding valid a transaction of a *de facto* corporation is an authority for holding that an *ultra vires* transaction of a *de jure* corporation is valid. The Supreme Court has recognized the truth of this proposition by citing *Smith v. Sheely* in subsequent cases on *ultra vires* acquisitions of property by *de jure* corporations.\(^6^7\) It is unfortunate that the Court did not keep this in mind when dealing with *ultra vires* contracts.

**B. Ultra Vires Acquisitions of Security — National Bank v. Matthews**

Because of a different interplay of interests it is desirable to take up this line of cases separately, despite the fact that it is part of the larger problem of *ultra vires* acquisitions of property.

In *National Bank v. Lanier*\(^6^8\) the bank in violation of a statutory prohibition made a loan to one of its stockholders upon the security of its own stock and later sold the stock and applied the proceeds on the loan. After some but before all the stock had been transferred by the bank, the stockholder sold the stock to the plaintiff. The court allowed recovery in an action by the plaintiff against the bank for damages because of its refusal to recognize

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\(^{65}\) Id. at 361.

\(^{67}\) See Myers v. Croft, 13 Wall. 291, 295, 20 L. Ed. 569 (1871); Jones v. Habersham, supra n. 51, at 188; Fritts v. Palmer, supra n. 57, at 292-293.

\(^{68}\) 11 Wall. 369, 20 L. Ed. 172 (1870).
him as a stockholder. In holding that the security of the bank was void the Court said:

"The contract in its inception was in violation of law, and the bank cannot complain if it is made to suffer in consequence of it."

Because of the fact that the stock certificate was never pledged with the bank, the result is of course sound.

However, on the question of ultra vires security the Court took a more liberal view in National Bank v. Matthews. In that case A had executed to B a note secured by a deed of trust of land which was in effect a mortgage with a power of sale. The national bank made a loan to B taking as security an assignment of A's note and the deed of trust. Upon B's failure to pay the loan at maturity the bank directed a sale by the trustee named in the deed of trust. A thereupon filed his bill in a state court to enjoin the sale on the ground that the bank was acting ultra vires in lending upon real estate security and consequently that the deed of trust in the hands of the bank was void. The injunction was granted by the state court but this decree was set aside by the Supreme Court which gave two grounds for its decision. The first was that the bank had not really made a loan on real estate security — that the loan to A had been made by B and that the bank in taking an assignment of A's note as security for a loan by the bank to B, which was clearly intra vires would have had the benefit of the deed of trust even if it had not been specifically assigned, on the principle of equity that the security follows the debt as an incident of its ownership. However, the court placed little emphasis on this point. The other and more important ground and the one for which this has become a leading case is that even if this had been a direct loan by the bank on real estate security, which was admittedly prohibited by the National Banking Act, the security would nevertheless be valid as against the borrower, the government alone being allowed to question the bank's authority. In support of this position the Court cited the line of cases dealing with ultra vires acquisitions of property.

In the course of its opinion the Court pointed out that behind the prohibition of such loans was an effort to protect the social interests in favor of keeping the assets of the bank liquid, of pre-

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69 Id. at 375.
70 98 U. S. 621, 25 L. Ed. 188 (1878).
71 Id. at 625-626.
venting hazardous speculation in real estate and of preventing the accumulation of lands in mortmain.\textsuperscript{72} The Court realized that to declare the security void would tend to defeat the first two interests, the real beneficiaries of which were the stockholders, the depositors and other creditors of the bank.\textsuperscript{73} Also to be taken into account was the interest in the security of acquisitions which would have been endangered by the inconvenience and insecurity which would follow if all such transactions were held void and the deeds held subject to collateral attack. Such policy as there was against mortmain and the general policy in favor of keeping corporate action within the bounds of authority granted by the government were felt to be sufficiently protected by the threat of ouster and dissolution.

Thus, upon a weighing of all the interests involved, the Court arrived at the conclusion that the \textit{ultra vires} action must be held valid. Therefore it argued that since Congress had not stipulated for a forfeiture in such case, the only check intended must have been the threat of action by the government.

"The statute does not declare such a security void. It is silent upon the subject. If Congress so meant, it would have been easy to say so; and it is hardly to be believed that this would not have been done, instead of leaving the question to be settled by the uncertain result of litigation and judicial decision.\textsuperscript{74}"

".... The impending danger of a judgment of ouster and dissolution was, we think, the check, and none other contemplated by Congress.

"That has been always the punishment prescribed for the wanton violation of a charter, and it may be made to follow whenever the proper public authority shall see fit to invoke its application. A private person cannot, directly or indirectly, usurp this function of the government."\textsuperscript{75}

This line of argument, which is indeed convincing enough, is unfortunately reserved for those cases in which the Supreme Court thinks it desirable to hold the \textit{ultra vires} transaction valid. Though equally applicable to cases dealing with \textit{ultra vires} contracts, it has been almost wholly disregarded by the Court in its decisions on that subject.

There are numerous cases following \textit{National Bank v.}

\textsuperscript{72} \textit{Id.} at 626.
\textsuperscript{73} \textit{Id.} at 629.
\textsuperscript{74} \textit{Id.} at 627.
\textsuperscript{75} \textit{Id.} at 629.
Matthews, the rule being applied alike to ultra vires loans on realty and on personalty.76 In Thompson v. The Bank77 the Court went so far as to say that any violation by a national bank of prohibitions in the Banking Act would subject it only to the penalties there enumerated and that the validity of the transaction could be questioned by the government alone, but this has not been followed. In McCormick v. National Bank78 the Court held void a lease made by the bank after incorporation but in violation of a restriction on its commencing business before being authorized to do so by the Comptroller of the Currency. Not only does this run counter to the argument in National Bank v. Matthews which would certainly warrant the broad statement made in the Thompson case, but in treating the lease purely as a contract the Court lost sight of the fact that it was also an acquisition of property. This was recognized in one case,79 but it should be added that the Court has generally treated unauthorized leases simply as ultra vires contracts.80

C. Incidents of Ownership of Property Acquired Ultra Viros — National Bank v. Kennedy

Implicit in the Supreme Court doctrine as to ultra vires acquisitions of property is the corollary that the corporation has those benefits normally incident to ownership. It is entitled to the income and use of the property, it may sue in ejectment to maintain its right to possession, and it may convey a good title to a purchaser from it. But immediately this question arises — having been given the benefits incident to its ultra vires ownership, should not the corporation be equally liable for the burdens incident to such ownership? In National Bank v. Kennedy81 the Supreme Court answered this question emphatically in the negative.

In that case the bank had become the owner of stock in a


77 146 U. S. 240, 251, 13 S. Ct. 66 (1892).

78 165 U. S. 538, 17 S. Ct. 433 (1897).


80 Infra, V.-B-(2)-(b), dealing with ultra vires leases by public service companies.

81 167 U. S. 362, 17 S. Ct. 831 (1897).
savings bank and had received several dividends on this stock. Upon the failure of the savings bank a creditor attempted to hold the national bank to its secondary liability as a stockholder. The Supreme Court sustained the bank's defense that because its ownership was *ultra vires* it was not liable.

True enough, in reaching this result, the Court treated the liability of a stockholder as contractual and applied its rule that *ultra vires* contracts are void. However, the Court's statement that the transaction was "absolutely void" would seem necessarily to mean that the bank never became the owner of the stock, which would be directly in conflict with the line of cases following *National Bank v. Matthews*. Perhaps all that the case holds is that viewing the stockholder's liability as contractual, a corporation is not bound when the acquisition of the stock is *ultra vires* because in such a case its contract to be secondarily liable is void.

Stated in this way, however, the case is inconsistent with *Christopher v. Norvell.* In that case a married woman tried to escape liability on national bank stock owned by her on the ground that by the law of Florida a married woman was legally incapable of making a contract. In holding her liable the Supreme Court said in substance that a stockholder's liability instead of being contractual was imposed by statute as an incident of the ownership of the stock.

"The statute, in effect, says to all who become owners of national bank stock, no matter in what way they become shareholders, that they cannot enjoy the benefits accruing to shareholders, and escape liability for the contracts, debts and engagements of the bank."}

With this statement compare one from *National Bank v. Kennedy*:

"The claim that the bank in consequence of the receipt by it of dividends on the stock of the savings bank is estopped from questioning its ownership and consequent liability, is but a reiteration of the contention that the acquiring of stock by the bank under the circumstances disclosed was not void but merely voidable. It would be a contradiction in terms to assert that there was a total want of power by any act to assume the liability, and yet to say that by a particular act the liability resulted."}

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62 201 U. S. 216, 26 S. Ct. 502 (1906).
63 *Id.* at 229.
64 *Supra* n. 81, at 371.
Thus by avoiding one contradiction in terms which was of its own making, the Court has given us a choice of alternatives each of which is equally contradictory to its other holdings. On the one hand, it may be said that a national bank never becomes the owner of stock acquired ultra vires, but this is in conflict with National Bank v. Matthews and the other cases on the ultra vires acquisition of property. On the other hand, it may be said that a stockholder’s liability is contractual and that a corporation is not liable when such contract is ultra vires, but this is in conflict with the Norvell case which holds that the liability is merely an incident of the ownership of the stock.

Or perhaps a reconciliation of these decisions may be achieved by saying that though the liability of a corporation as a stockholder is contractual, that of a natural person is not. As illogical as this may seem, the Supreme Court has intimated as much. In National Bank v. Hawkins where the rule of National Bank v. Kennedy was reaffirmed, this question was expressly left open, the Court saying that "whether, in the case of persons sui juris, this liability is to be regarded as a contractual incident to the ownership of the stock, or as a statutory obligation, does not seem to present a practical question in the present case."85 It is indeed surprising that anyone should seriously contend that the nature of the secondary liability on a given share of stock will vary depending upon whether the stockholder happens to be a natural person or a corporation. However, this seems to be the result of the holding in these cases.

Although the Supreme Court has followed National Bank v. Kennedy,86 there is no justification for the rule established in that case. That the Court is itself dissatisfied with the decision is evidenced by its reluctance to extend the rule to situations which though within the spirit are not within the letter of the holding. In Robinson v. National Bank87 the bank had made a loan on the security of stock in another national bank and upon default had bid in the stock at a nominal price. In holding that the bank was not liable as a stockholder on the ground that it had never become the owner, the stock being still in the name of the pledgor and being held by the bank even after the sale simply as

collateral, the Court commented on the cases following *National Bank v. Kennedy* and said that it was "... not disposed, as at present advised, to push the principle of these cases so far as to exempt such banks from liability as other shareholders, where they have accepted and hold stock of other corporations as collateral security for money advanced, (a proposition which we withhold from decision,) ..." It is not clear that this restriction on the rule in *National Bank v. Kennedy* has been definitely imposed but it is quite arguable that it has. In *National Bank v. Hulitt*, the facts of which were similar to those in *Robinson v. National Bank* except that the bank had had a transfer of the pledged stock made to one of its employees, the Court held the bank liable. The catch is, however, that although the question of the bank's authority was raised in the argument of the case, no mention of this matter is found in the Court's opinion. But if this circumstance be disregarded, on the basis of the result of the case it seems safe to say that without regard to the question of its authority a national bank is liable as a stockholder when it becomes the owner of stock pledged to it as collateral. And of course, as applied to this situation, the rule is put in line with *National Bank v. Matthews* and the *Norvell* case.

But even with this restriction the principle of *National Bank v. Kennedy* is thoroughly unsound. A national bank which has invested a large part of its capital in the stock of another bank could receive all the benefits of its position as a stockholder and still in the event of a crash it could by pleading *ultra vires* avoid all the burdens of that position. It is to be hoped that the Court will discard this highly inequitable rule, and certainly in its decisions there is ample authority for so doing.

In *Salt Lake City v. Hollister* the Court held that a municipal corporation which had received the pecuniary benefits of the *ultra vires* manufacture of liquor could not escape the burden of taxation by pleading its want of authority to engage in such business. But aside from the analogy of that case where the corporation was municipal rather than private, a just result would be reached in the problem presented by *National Bank v. Kennedy* if the Court would simply apply its rule as to *ultra vires* acquisitions of property by which the bank would be held to be the owner of

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88 Id. at 309-310.
89 204 U. S. 162, 27 S. Ct. 179 (1907).
90 Id. at 165.
91 118 U. S. 256, 6 S. Ct. 1055 (1886).
the stock, and the rule of the Norvell case that the secondary liability of a stockholder is merely an incident of ownership. Such a change in the law in addition to promoting a more just solution would also serve to make the decisions of the Court more logically consistent.

Little can be said for the rule as it now stands, and the Court in National Bank v. Hawkins was indeed hard pressed to find some justification for it. The best it could do was first to discover, in the requirement that three-fourths of the directors of a national bank be residents of the district where it is located, a policy favoring local management which would be defeated by allowing distant banks to acquire stock control, and second to point out that the then existing policy in favor of competition between banks would be defeated by the concentration of all the capital of a community in one concern.92 Aside from the fact that both these policies are sufficiently protected by the right of the government to revoke the charter of an offending bank, what the Court really did was to endanger both of the policies which it claimed to be protecting by making these ultra vires investments more attractive, thereby encouraging them. Also, any possible argument as to the hardship on the creditors and stockholders of the holding bank which would follow an imposition of liability on it is more than offset by the corresponding injustice to the creditors of the other bank which has already failed. And whatever may be the arguments against the imposition of liability on the holding bank, they have been disregarded in those cases where the bank has become the owner of stock taken as security, though they would seem to be as applicable in that situation as in any other.

The truth of the matter is that the Court here followed its strict doctrine without making that careful weighing of the interests involved, which weighing has resulted in its refusal to apply that doctrine in most of the cases considered so far.

Here again, in connection with the ultra vires acquisition of property, we have seen that by and large the Supreme Court has refused to make a logical application of the Fiction Theory and has made steady progress toward the adoption of the Realist Theory. Its original doctrine was modified so as to give validity to these ultra vires transactions because it was only in this way that protection could be afforded to compelling interests, particularly the interest in favor of the security of acquisitions. And even

92174 U. S. 364, 368-369, 19 S. Ct. 739 (1899).
on the question of corporate liability for burdens normally incident to ownership, where the Court at first applied its strict doctrine in National Bank v. Kennedy, we have seen in the Court’s tendency to restrict the rule of that case this same progress toward liberalization. As a consequence, it is not unreasonable to anticipate that the same considerations which have influenced the Court’s progress so far will eventually lead it to repudiate this anomalous and unjust decision.

V. Ultra Vires Contracts

A. In General

It is in cases dealing with ultra vires contracts that the Supreme Court has clung most obstinately to its original doctrine that ultra vires transactions are void. Its more positive assertions of this doctrine have been in cases where the contracts were not only ultra vires but were also thought to be against public policy. But even in this line of cases, both in those where the contracts were against public policy as well as ultra vires and in those where they were ultra vires only, the Court has under the pressure of conflicting interests felt bound to retreat from its original position to a considerable extent. This retreat has largely been accomplished under cover of the questionable distinction between a lack of authority and an abuse of authority and under the guise of recovery in quasi-contracts. However, before taking up the cases involving a repudiation of the strict doctrine let us consider those in which it was established.

Here again the Court started from the position inherent in the Fiction Theory that a corporation is incapable of doing any act not authorized by the state. Logically applying this doctrine, as expressed in Head v. Providence Insurance Co. and in the dictum of Chief Justice Taney in Bank of Augusta v. Earle that contracts beyond the power of a corporation are void, the Supreme Court early held that a railroad corporation was not liable on notes given in payment for a steamboat purchased ultra vires.93 It is interesting to observe that in this case the Court gave a clear statement of the reasons for its strict doctrine as to ultra vires contracts, which statement still remains the Court’s only justification of it. The reasons given were: (1) that an ultra vires contract works a diversion of capital from the objects contemplated by the charter

93 Pearce v. Madison & Ind. R. R. Co., 21 How. 441, 16 L. Ed. 184 (1858).
to the detriment of non-assenting stockholders, (2) that a contract to do an ultra vires act is a contract to do an illegal act, and (3) that the illegality of this act is apparent by the provisions of a public act of which all persons dealing with the corporation have notice. The merit of these reasons will be considered later.

Although the position taken by the Court in this case has never been entirely abandoned, it has been maintained only with the greatest difficulty. Indeed, in a series of cases decided in 1877 and 1878 there was, mostly by way of dictum, real promise that the Court was going to give this question of ultra vires contracts the same liberal treatment it had given the problem of other ultra vires action.

This is particularly apparent in the decisions of Justice Swayne who in 1878 wrote the very liberal opinion in National Bank v. Matthews. For instance, while in Railway Co. v. McCarthy it was held that a contract by the company for the carriage of goods beyond its line was intra vires, he said that "The doctrine of ultra vires, when invoked for or against a corporation, should not be allowed to prevail where it would defeat the ends of justice or work a legal wrong." In support of this proposition he cited Whitney Arms Co. v. Barlow, a leading state court decision holding that if one party to an ultra vires contract has performed his side of it, the other party is bound on the contract.

Another example is San Antonio v. Mehaffy where the city was sued on unsealed securities, purporting to be bonds, which had been issued under a statute providing for the issue of bonds and also providing that the proper officers might "otherwise pledge the faith of the city". It was argued that the securities were void because of a lack of compliance with the provision for the issue of bonds, but the Court held them valid under the other clause in the statute. Here again Justice Swayne went even further and said:

"If that clause were wanting, we should have no difficulty in holding that the city was, under the circumstances, estopped from denying their validity. The doctrine of ultra vires, whether invoked for or against a corporation, is not favored in the law. It should never be applied where it will defeat the ends of justice, if such a result can be avoided."
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Then in Hitchcock v. Galveston99 the Court came very near to enforcing an ultra vires contract if it did not actually do so. In that case the city contracted to pay for street improvements in bonds which it was not authorized to issue. Notice that the only thing promised by the city was the performance of an ultra vires act. In holding the city liable on the contract the Court said that:

"The promise to give bonds to the plaintiffs in payment of what they undertook to do was, therefore, at farthest, only ultra vires; and, in such a case, though specific performance of an engagement to do a thing transgressive of its corporate power may not be enforced, the corporation can be held liable on its contract. Having received benefits at the expense of the other contracting party, it cannot object that it was not empowered to perform what it promised in return, in the mode in which it promised to perform."100

It may be said that recovery was properly allowed on the basis of an implied promise to pay. The answer to that proposition is that the measure of recovery here was the contract price and not the reasonable value of the plaintiff's performance. It must be admitted that this case can be distinguished from the case of a truly ultra vires contract on the ground that the city really made two promises, one to pay the contract price which it was authorized to do and the other to pay in bonds which was ultra vires, and that all the Court did was to enforce the first promise. But query whether the Court had any such thing in mind — the theory of the Court seems to be that though specific performance of an ultra vires contract cannot be granted, damages for breach of the contract will be.

Recovery was again allowed on an ultra vires contract in Gold-Mining Co. v. National Bank.101 There the bank had made a loan to the defendant by way of overdraft which with interest amounted to over $30,000. The bank was expressly prohibited from lending more than one-tenth of the amount of its capital stock to any one person or concern which in this instance imposed a limit of $5,000. In allowing a recovery at law of the full amount of the loan the Court said:

99 96 U. S. 341, 24 L. Ed. 659 (1877).
100 Id. at 351. Accord, Fort Worth City Co. v. Smith Bridge Co., 151 U. S. 294, 392, 14 S. Ct. 339 (1894).
101 96 U. S. 640, 24 L. Ed. 648 (1877).
"We do not think that public policy requires or that Congress intended that an excess of loans beyond the proportion specified should enable the borrower to avoid the payment of the money actually received by him. This would be to injure the interests of creditors, stockholders, and all who have an interest in the safety and prosperity of the bank."\textsuperscript{102}

Here we have a clear recognition that the matter is not closed once it has been determined that the transaction is \textit{ultra vires}. It was realized that the Court must go further and weigh the conflicting interests involved.

It may well be that there has been read into these cases more than they warrant. It should also be admitted that because several were cases dealing with municipal corporations, they may not be a proper basis for any generalization about the law of private corporations. On the other hand, since the doctrine of \textit{ultra vires} is usually applied more strictly in the case of a municipal corporation than in the case of a private corporation, it would seem that the liberality of these decisions becomes accentuated. But however that may be, it is certainly true that whatever liberality of approach this series of cases may properly be said to evidence was definitely counteracted in 1879 by the decision in \textit{Thomas v. West Jersey R. R. Co.},\textsuperscript{103} which must be considered in detail in another connection. Suffice it now to say that in that case, under the influence of the then recent English case of \textit{Ashbury Ry. Co. v. Riche},\textsuperscript{104} the Supreme Court reaffirmed its original strict doctrine.

This reaction did not go so far as to undo most of what had already been accomplished but it did make considerably more difficult all efforts toward further liberalization. The changed attitude of the Court is evidenced by the fact that instead of dicta as to the undesirability of the doctrine of \textit{ultra vires} one finds in later cases reassertions of the doctrine even where the transaction was held \textit{intra vires}. Thus, while the contract in \textit{Green Bay & Minn. R. R. Co. v. Union Steamboat Co.}\textsuperscript{105} was found to have been authorized, the Court referred to the "well settled" doctrine that no action can be maintained on an \textit{ultra vires} contract. And in \textit{Pittsburgh R. R. Co. v. Keokuk Bridge Co.},\textsuperscript{106} where again the contract was held \textit{intra vires}, the Court gave a clear and detailed

\textsuperscript{102} Id. at 642.
\textsuperscript{103} 101 U. S. 71, 25 L. Ed. 950 (1879).
\textsuperscript{104} (1879) L. R. 7 H. L. 663.
\textsuperscript{105} 107 U. S. 98, 100, 2 S. Ct. 221 (1882).
\textsuperscript{106} 131 U. S. 371, 384-385, 9 S. Ct. 770 (1889).
exposition of the reasons for its *ultra vires* doctrine. Also in *Jacksonville Ry. Co. v. Hooper*\(^{107}\) the Court again went out of its way to reaffirm its stand. On the other hand, there have been some later cases, though surprisingly few, directly holding contracts void when they were *ultra vires* but otherwise unobjectionable.\(^{108}\)

In view of the fact that the Supreme Court has made no clear distinction between cases in which the contracts were simply *ultra vires* and those in which they were both *ultra vires* and also illegal or against some public policy, the Court indiscriminately citing the one line of cases as authority for the other, an examination of the Court’s justification of its doctrine is postponed until the latter cases have been considered.

**B. Contracts Illegal or Against Public Policy**

(1) Usury.

This whole matter of usury was early regulated by statute and was thus taken out of the operation of the Court’s doctrine of *ultra vires*. However, it will be of interest to consider a few of the cases dealing with this question and to bring out its relation to the problem of unauthorized corporate action in general.

Although only by way of dictum in *Fleckner v. Bank of the United States*,\(^ {109}\) decided in 1823, the Court’s earliest statement on the subject of usury was far more liberal than might have been expected. In that case *A* gave his promissory note to *B* who subsequently transferred it to *C*. The bank discounted the note for *C*, deducting the legal rate of interest in advance. When *A* was sued by the bank he claimed that since the bank’s charter prohibited the collection of more than the legal rate of interest, the discount was usurious and therefore the note in the hands of the bank was void. It was held that the deduction of legal interest in advance was not usury, but Justice Story went further and said that even if it were, the contract would not necessarily be void. He first pointed out that most statutes specifically declared that usurious contracts were void, and on the basis of this he argued that since such contracts were only prohibited by the bank’s charter and were not declared void, they would be valid at least so far as

\(^{107}\) 160 U. S. 514, 524, 16 S. Ct. 379 (1896).


\(^{109}\) 8 Wheat. 338, 5 L. Ed. 631 (1823).
those not parties to the usury were concerned. He then went on to say that for the violation of the charter a proceeding by the government was the proper remedy.\(^{110}\) Although the case is not directly in point, the intimation is clear that the making of a contract expressly prohibited is not necessarily void even as to the parties to the contract and that the remedy for such unauthorized action is a proceeding by the government.

However, a few years later the Court went the other way when the problem was directly presented. In *Bank of the United States v. Owens*\(^{111}\) it was held that a contract calling for more than the rate of interest allowed by the charter was illegal and wholly void even though the act of incorporation did not so provide. This remained the rule of the Supreme Court until the whole problem was settled by statute. Most of the Supreme Court cases involving the question of usury have been those dealing with national banks, and in respect to them the contract was void until 1864 when an Act of Congress provided that the only penalty should be a forfeiture of interest. There is a full discussion of this and subsequent acts and of their effect upon conflicting state statutes in *National Bank v. Dearing*\(^{112}\)

In *McBroom v. Scottish Mortgage Co.*,\(^{113}\) where the question was the construction of a state-usury statute, the Court made the broad statement that when a corporate act is prohibited and a penalty imposed, the legislature must have intended as checks on such action only the penalty enumerated and the threat of a *quo warranto* proceeding. In the course of its opinion the Court cited Justice Story's dictum in the *Fleckner* case, the opinion in the *Dearing* case, decisions on the taking of *ultra vires* security by national banks and decisions on *ultra vires* acquisitions of property, saying that all these cases come under the same general principle.

It should be noted that in most of the instances cited there was no penalty imposed. This would then make the general proposition read that unless an unauthorized corporate act is expressly declared void, the legislature must have intended no checks other than the threat of state action or the imposition of the penalty, if any, specified. While the Court failed to mention any of its decisions which are in conflict with this proposition, it is a fair

\(^{110}\) *Id.* at 354-355.
\(^{111}\) 2 Pet. 527, 538, 7 L. Ed. 508 (1829).
\(^{112}\) 91 U. S. 29, 35-36, 23 L. Ed. 196 (1875).
\(^{113}\) 153 U. S. 318, 325-327, 14 S. Ct. 852 (1894).
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statement of the result reached by the Court in most of the cases considered so far. It is a perfectly sound principle and it seems clear that no entirely satisfactory treatment of this whole problem of ultra vires transactions may be expected until it is applied to all cases alike.

(2) Transfers of property and franchises by public service corporations.

(a) The public policy against such transfers.

The Supreme Court has long recognized that there is a policy against the unauthorized transfer by a public service corporation of its property and franchises whereby it incapacitates itself to perform the duties it owes the public. Thus in York & Md. R. R. Co. v. Winans114 it was held that by such a transfer the corporation could not escape responsibility and that it was liable for patent infringements by the transferee.

"Important franchises were conferred upon the corporation to enable it to provide the facilities to communication and intercourse, required for the public convenience. . . . The corporation cannot absolve itself from the performance of its obligations, without the consent of the legislature."115

And in Railroad Co. v. Brown116 it was held that the lessor corporation was liable to a passenger for an injury inflicted by a servant of the lessee.

Admitting, then, that there is a public policy against such transfers and that as a check on them it is proper to impose full responsibility on the transferor in respect to duties owed to third parties, the question remains whether this policy is so strong as to require that all transfers in violation thereof be held illegal and void as between the parties. On this point the courts have differed. In a well-reasoned opinion holding that such a lease was not void, the New York Court said:

"We think the demands of public policy are fully satisfied by holding that, as to the public, the lease was void, but that, as between the parties, so long as the occupation under the lease continued, the lessee was bound to pay the rent, and that its recovery may be enforced by action on the covenant. Public policy is promoted by the discouragement of fraud and the maintenance of the obligation of contracts. . . ."

114 17 How. 30, 15 L. Ed. 27 (1854).
115 Id. at 39.
116 17 Wall. 445, 450, 21 L. Ed. 675 (1873).
Here it was recognized that a policy against such transfers does exist but it was also seen that there was a countervailing policy in favor of the security of business transactions and that the decision should turn upon a proper evaluation of those policies and of the other conflicting interests involved.

Whether or not the New York Court was correct in holding that the policy against transfers by public service companies is not strong enough to make the transfer wholly void, which would seem to be the better view, the United States Supreme Court has held otherwise. If the Court had placed its decision solely on the ground of the policy against such transfers, little fault could be found except to disagree with the Court's view as to the strength of the policy involved. However, this question of policy, if mentioned at all, has been used rather as a secondary ground, and the decisions have been based primarily on the doctrine that all ultra vires contracts are void.

(b) Transfers by way of lease.

*Thomas v. West Jersey R. R. Co.*, 116 decided in 1879, was the first case in which the Supreme Court held that an ultra vires lease by a railroad of all its property and franchises was illegal and void. This case has already been referred to as the one which definitely checked the movement toward liberalization which was gaining such strength in 1877 and 1878. In the main body of the opinion the Court treats the case as simply one involving the problem of the effect of an ultra vires contract. The English cases from 1850 to 1875, culminating in *Ashbury Ry. Co. v. Riche*,119 are discussed at length, the Court concluding that they establish the broad doctrine that an ultra vires contract is void, that it cannot be made valid by the assent of every one of the shareholders, and that a complete or partial performance of it will give rise to no right of action on the contract. The Court very neatly side-stepped a consideration of the more liberal statements which it had itself just recently made by saying that:

"It would be a waste of time to attempt to examine the American cases on the subject, which are more or less conflicting, but we think we are warranted in saying that this latest decision of the House of Lords represents the decided preponderance of authority, both in this country and in England, and is based upon sound principle."120

118 101 U. S. 71, 25 L. Ed. 950 (1879).
119 (1875) L. R. 7 H. L. 653.
120 *Supra* n. 118, at 83.
The Court then threw in as good measure the proposition that such a lease by a public service corporation is against public policy as well as ultra vires and hence illegal and void on this account alone. But as a matter of fact it would seem that the policy was lacking in this case because New Jersey, where the corporation was formed and whose policy alone could have been infringed, subsequent to the making of the lease had passed a statute relative to the rates to be charged by the company in which reference was twice made to the "railroad or its lessees". The Court admitted that it could be fairly inferred from this that the legislature knew of the lease but went on to say that:

"It is not by such an incidental use of the word 'lessees' in an effort to make sure that all who collected fares should be bound by the law, that a contract unauthorized by the charter, and forbidden by public policy, is to be made valid and ratified by the State."

But query — one of the provisions of the act was that nothing contained in it should deprive the railroad or its lessees of any of the benefits conferred by a prior act. This definitely seems to be something more than a mere effort to see that those who collected fares should be bound by the law.

But even if the Court was correct in saying that the public policy against such leases was present in this case, we still have the question whether the policy was strong enough to require that the lease be held void. That the Court itself does not think the policy is really so strong as some of its pronouncements would seem to make it is evidenced by its decisions, to be considered later, in which recovery was allowed in quasi-contracts.

Since the decision in the Thomas case it has been the settled rule of the Supreme Court that a lease by a public service company of all its property and franchises is illegal and void and can be the basis of no action at law between the parties. In the many cases applying this rule the Court has made no effort to place its decision solely on the ground that such contracts are against public

121 Id. at 83-84.
122 Id. at 85.
policy but has more often treated the transaction as simply an *ultra vires* contract. This line of cases has been most frequently cited and quoted in those decisions dealing with contracts which were *ultra vires* only.

And the Court has by no means been consistent in its application of the rule. Consider first this statement from the *Central Transportation Company* case:

"A contract of a corporation, which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it."¹²⁴

Then with that statement compare the result reached in the *Terre Haute* case where the Court dismissed a bill by the lessor to set aside and cancel a 99 year *ultra vires* lease after performance by the lessee for seventeen years.¹²³ The Court denied the relief on the ground that the parties to the contract were in *pari delicto* and that consequently neither a court of law nor a court of equity would assist the plaintiff to recover the property conveyed under the contract. This is a very definite holding that the corporation did make the contract and that the objection is that it ought not to have made it, which is just the reverse of the statement quoted above. And in *United States v. Union Pacific R. R. Co.*¹²⁶ it was held that the corporation did make the contract and that the state could have it set aside. In fact the Court has seldom taken seriously its statement in the *Central Transportation Company* case that a corporation is incapable of making an *ultra vires* contract, but has generally proceeded at once to a consideration of the legal effect to be given the *ultra vires* contract which admittedly the corporation had made.

It should also be noted that in the *Terre Haute* case the Court applied the rule applicable to a wholly executed illegal transaction. But it was recognized by the Court in the *Thomas* case that as to the future such a lease is executory. This raises a query relative to the public policy against these leases. Would not the policy, which invalidates the lease because of a desire to have the original grantee of the franchise perform his duties to the public, be better

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¹²⁵ Supra n. 123.
¹²⁶ 160 U. S. 1, 16 S. Ct. 190 (1895).
served by allowing him to undo the wrong and thus resume his duties than by denying him any relief whatever, especially when such denial in effect makes the transaction valid so long as the lessee wishes to perform?

The truth of the matter seems to be that the Court has never given serious consideration to this argument about public policy, using it rather as a secondary prop for its doctrine of *ultra vires*. This is borne out by the decisions allowing recovery in quasi-contracts and by a statement in the *Central Transportation Company* case which has often been quoted in those decisions. In that case the Court said:

"A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, 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."

It is obviously impossible to reconcile these various statements and the decisions reached by the Court in this single line of cases, and it is still more impossible to reconcile them with the other decisions of the Court in which validity has been given to *ultra vires* corporate action. It is not possible for the Court to pay lip service to the *Fiction Theory*, which is really at the bottom of the strict language in the *Central Transportation Company* case, and at the same time be logically consistent in giving validity either directly or indirectly to other *ultra vires* action.

(c) Transfers by way of sale.

In dealing with the unauthorized sale by a public service company of all its property and franchises in which case the policy in favor of the security of acquisitions comes into play with full force, the Court has disregarded those considerations which were thought to be controlling in the case of a lease by such a corporation and has held the transfer valid. Here again is a demonstration of the proposition that regardless of what the Court has said, its result has in fact turned upon a weighing of the interests for and against the *ultra vires* transaction, the Court not hesitating

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127 *Supra* n. 124, at 60.
to hold it valid whenever it was convinced that the balance of interests was in favor of doing so.

In Railroad Co. v. Howard, where it was claimed that the sale was unauthorized and void, the Court said that this claim "is entitled to no weight, as the contract was ultimately carried into effect by the consent or subsequent ratification of all parties interested in the subject-matter of the sale." With this statement should be compared the many instances where the Court has said that no amount of consent or ratification could possibly give validity to an ultra vires contract. Though only by way of dictum another statement that an unauthorized sale of assets by a public service company is not open to collateral attack is found in Branch v. Jesup, decided after the Court had reaffirmed its strict view in the Thomas case.

Thus it is seen that even in the line of cases where the court comes nearest to being justified in the application of its doctrine, it has not applied it consistently but has held the transfer valid when it was recognized that the policy favoring the security of acquisitions demanded that result.

(To be concluded.)

128 7 Wall. 392, 415, 19 L. Ed. 117 (1868).