THE ULTRA VIRES DOCTRINE AS APPLIED TO COMPANIES

A COMPARATIVE STUDY

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Abstract

A comparative dissertation presented on the history and development of the doctrine of *Ultra Vires* as applied to companies, beginning with the origins of the doctrine and its development in England, up until the *Companies Act 1989 (UK)*, covering reforms of the Ultra Vires doctrine in English law; its application and position in Malaysia, and a consideration and development of Ultra Vires in Australia particularly in respect of the *Corporation Law.*

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by

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Chapter 1

ORIGINS OF THE DOCTRINE OF ULTRA VIRES AND ITS DEVELOPMENT IN ENGLAND

Introduction

This chapter examines the development of the legal doctrine *of ultra vires* in the United Kingdom in relation to the capacity of a company to enter into various transactions.

The Latin preposition and adverb *'Ultra'*, meaning 'beyond', was adopted as an English noun in the early 19th century. When applied to a person it refers to a person who goes beyond others in opinion or action of the kind in question.[1] The phrase *'Ultra vires'* used in the legal sense thus means 'outside the powers'.

Before the United Kingdom *Joint Stock Companies Act 1856*, companies were formed on the basis of a *deed of settlement* – an elaborate form of partnership deed. The Act of 1844 provided for the registration of the deed of settlement and the grant of corporate status in return. The *1856 Act* introduced a new constitutional framework based on two documents – the *memorandum of association* and *articles of association* – and this format has subsisted in all successive UK *Companies Acts* to this day. Both these documents have also been loosely termed as the 'constitution' of the company.

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1 *H.W. Fowler, 'A dictionary of Modern English Usage'*, Oxford University Press, 1996 reissue.

Memorandum of Association, and its perceived non-alterability

Of the two documents discussed above, the memorandum has been declared the more fundamental in character;[2] and originally this question of alterability signalled the distinction between the memorandum and the articles. Apart from changing its name[3], and increasing its capital, a company was not allowed, under the *1856 Act*, to alter any of the terms of the memorandum. In contrast, the articles could be changed by special resolution of the members.

By its memorandum, a company proclaims to all the world the external aspect of its constitution, such as its name, domicil, objects, status,[4] and capital structure. On the other hand, the articles are concerned with matters of internal organisation of the members *inter se*, and in regard to their rights as against the company.[5]

While the articles of association regulated the internal affairs of the company, of which the members were the absolute masters, i.e. the members may by way of a general meeting, alter the terms of the articles from time to time; any such alteration could not however, exceed the bounds set by the memorandum[6].

The situation is rather permissive today, for it is possible to alter virtually all the terms of the memorandum by resort to one procedure or another.[7] Thus any

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2 See for example *Guinness v Land Corporation of Ireland Ltd (1882) 22 Ch D 349 CA*, a case which held that in the event of a conflict between the terms of the memorandum and that of the articles, those of the memorandum are to prevail. There are also statutory provisions in the UK Act, e.g. *s 125 CA 1985*, which make it possible to 'entrench' certain rights by writing them into the memorandum, with a prohibition or restriction on their alteration. Other provisions in the *CA 1985* also confirm the elevated position of the memorandum, whether by express words or by necessary implication, e.g. *ss 9*, and *17(2)*.

3 in rather limited circumstances

4 For example, whether the nature of the company is limited, unlimited, public or private. In Malaysia *s 18* of the *Companies Act 1965* [hereinafter *CA 1965 (Malaysia)]* lists out all the matters that are to be included in the memorandum. *Section 15 CA 1965 (Mal)* sets out the legal requirements of a private limited company.

5 For example, the manner of holding shareholders and directors' meetings, the payment of dividends; the appointment, removal, retirement, and remuneration of directors, etc.

6 Ashbury Railway Carriage and Iron Works Co Ltd (1875) LR 7 HL 653, per Lord Cairns.

7 In Malaysia entrenched provisions may be altered by resorting to a Scheme of Arrangement under *s 176 CA 1965 (Mal)*.

distinction between the memorandum and the articles, purely on the basis of alterability is, in modern company law, somewhat slender. For example, in England, the name of the company may now be changed under *CA 1985, s 28*, the objects clause under *s 4*, the company's status as limited or unlimited, public or private, by resort to the various procedures set down in *Part II* of the *Act*, and the capital provisions under *ss 121, 125*, and *135*.

An important provision in the memorandum is the objects clause; which defined the capacity of the company. Up until 1948, the alteration of the company's objects in its memorandum required confirmation by the court; but thereafter the present procedure under *s 4 CA 1985* was substituted in its place. This substitute procedure allows a company to alter its objects by special resolution; and the court only becomes concerned if there is objection by the holders of 15% or more of the issued share capital of any class, by way of an application to the court, within 21 days of the resolution. The court then has an absolute discretion to allow or deny the alteration.[8]

In view of the emasculation of the *ultra vires* doctrine that would follow in the course of time, perhaps it is significant that the only reported cases on the exercise of the court's discretion, whether of the present procedure or the pre-1948 regime, seemed concerned with non-commercial organisations. For example, in *Re Cyclists Touring Club*[9], an association formed to promote cycling was not allowed to expand its objects so as to let motorists become members, since the interests of cyclists and those of the motorists were, to some extent, adverse to each other. In the case of *Re Hampstead Garden Suburb Trust Ltd*[10], a change in the objects of a homeowners' community trust was refused on a rather

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8 In Malaysia a number of provisions set out the procedure and the law in respect alteration of the objects clause. The main provisions are *ss 21* and *28 CA 1965 (Mal)*.

9 *[1907] 1 Ch 269*

10 *[1962] Ch 806, [1962] 2 All ER 879*

narrow construction of the statutory provisions; and the court, it would appear, being far more concerned that the object of the alteration was to bring about a scheme with property developers to build upon parts of land which were then vacant.

In contrast to this rather restrictive approach to any changes in the memorandum, legislation has always been far more open to alteration of articles, by special resolution, save for statutory constraints in regard to the protection of 'class rights'.[11] For instance, *s 16* of the *Act* renders ineffective any alteration, which increases the liability of a member, or one which obliges him to take more shares.[12]

The genesis of the ultra vires doctrine

The *Companies Act 1985, s 2(1)(c),* like every Companies Act since that of the *Joint Stock Companies Act 1856,* requires a company to include in its memorandum a statement of its objects. In Malaysia this requirement appears at *s 18(1)(b)* of the *Malaysian Companies Act 1965.*

This requirement was to protect two categories of people. The shareholders are entitled to know what was the purpose of the company to which they were entrusting their money. It has been said that an investor in a gold-mining company would not wish to see his savings frittered away in a 'fish and chips' business. Second, it would be reasonable for those who were the company's

11 *Section 125(2)* of *CA 1985.*

12 In Malaysia the law in respect of articles of association are set down under *s 21 CA 165 (Mal). Section 31* deals with the procedure in respect of alteration of articles. However there exist also other provisions which are also relevant in so far as amendments are concerned. For instance *s 21* refers to general provisions as to alteration of the memorandum of association, *s 23* refers to change of company name by way of special resolution; *s 25* applies in respect of a change of name from unlimited to limited company; and change from a 'public' company to a 'private' company is catered for under s 26.

creditors to want to know the scope of the company's business and the risks involved in the loan of funds.

The statement of the objects, or the 'objects clause' as it would later be known, was not mere window-dressing for the benefit of creditors and shareholders alone; it would soon become the basis of the development of the doctrine of ultra vires, which would dominate legal thinking in company law for over a century, the vestiges of which remain to this day.

Simply put, the ultra vires doctrine is a rule which is concerned with the *capacity* of a company. The doctrine imposed artificial limitations on the acts and things which a company could – or could not – do. The thrust of the doctrine is the principle that the company is incapable of doing anything which was not within the scope of its 'objects clause', or reasonably incidental to its 'objects clause'.[13] Thus any act falling outside the stated objects of the company was not only beyond the authority of the directors, but beyond the capacity of the company itself, and a nullity at law.

The doctrine had applied, prior to 1875, to 'statutory' companies incorporated by special Acts of Parliament. In such companies the doctrine of *ultra vires* had had a more substantial role. These companies had powers to compulsorily acquire land to construct railways and canals. It was logical therefore for the courts to keep the activities of such companies under their scrutiny, for the exercise of these powers could have been draconian. This strict approach, however, was not applied to 'deed of settlement' companies, for these were partnerships; and they were at liberty to alter their constitutions by mutual agreement of the members *inter se*. Then along came the1875 House of Lords case of *Ashbury Railway*

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13 This was a gloss put on the rule by *A-G v Great Eastern Railway Co (1880) 5 App Cas 473, (HL).*

Carriage & Iron Co Ltd v Riche,[14] which had the dual effect of confirming that the doctrine would also apply to companies registered under the Companies Acts; as well as the rather prohibitory principle that an ultra vires act of a company could not be validated even by unanimous ratification of its members in a general meeting.[15]

The doctrine of *ultra vires* has not been applied at all to companies incorporated by Royal Charter; where a chartered company ventured into questionable transactions it simply risked its charter being forfeited at the initiative of the Crown, but the transactions it had entered into were not, however, invalidated.[16]

The Common Law position

The common law position therefore was this: A company incorporated under the *Companies Act* has power to do only those things which were authorised by the memorandum of association.

In *Ashbury Railway Carriage and Iron Works Co Ltd*[17], Lord Cairns LC said:

> The *memorandum of association* is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit.

Anything not so authorised, expressly or implicitly, was *ultra vires* of the company and could not be ratified even by the unanimous agreement of the members.

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14 *[1875] LR 7 HL 633*

15 *LS Sealy, supra*, at p 147.

16 *Ibid.*

17 *(1875) LR 7 HL 653.*

It was there held that even the shareholders in general meeting could not ratify the act of the company if it was beyond its capacity.

Lord Cairns said:

> My Lords, that reference to the Act will enable me to dispose of a provision in the articles of association in the present case which was hardly dwelt upon in argument, but which I refer to in order that it may not be supposed to have been overlooked: 'An extension of the company's business beyond or for other than the objects or purposes express or implied in the memorandum of association shall take place only in pursuance of a special resolution.' In point of fact, no resolution for the extension of the business of the company was in this case come to; but even if it had been come to, it would have been entirely inept and inefficacious. There was, in this fourth article, an attempt to do the very thing which, by the Act of Parliament, was prohibited to be done – to claim and arrogate to the company a power under the guise of internal regulation to go beyond the objects or purposes expressed or implied in the memorandum.
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> Now, my Lords, bearing in mind the difference which I have just taken the liberty of pointing out to your Lordships between the memorandum and the articles, we arrive at once at all which appears to me to be necessary for the purpose of deciding this case .... I assume the contract in itself to be perfectly legal, to have nothing in it obnoxious to the doctrine involved in the expressions which I have used. The question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract. Now, I am clearly of the opinion that this contract was entirely, as I have said, beyond the objects in the memorandum of association. If so, it was thereby placed beyond the powers of the company to make the contract. If so, my Lords, it is not a question whether the

> contract was ever ratified or was not ratified. It was a contract void at the beginning, it was void because the company could not make the contract. If every shareholder of the company had been in the room, and every shareholder of the company had said, 'That is a contract which we desire to make, which we authorise the directors to make, to which we sanction the placing the seal of the company', the case would not have stood in any different position from that in which it stands now. The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by the Act of Parliament, they were prohibited from doing ...

The strength of the words used by Lord Cairns had a wide and negative effect, and would, for some considerable period of time, serve to nullify any action a company took outside of its objects.

Objects and powers

Despite the fact that the doctrine has the effect of confining the activities of the company, it also constricted the company's powers, which raises the question of the distinction between the two: It has been said that the line between objects and powers is an almost impossible one to draw[18], and not without reason. To begin with, the *Act of 1844*[19] required a statement of the business or the purposes of the company in the deed of settlement, but this was, at that time, liable to alteration by its members. Section 25 of the Act of 1844 defined the company's main 'powers' and 'privileges', which included the power to 'perform all other Acts

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18 *LS Sealy*, 'Cases and materials in Company Law', 6th Ed. Butterworths, 1996, p 148.

19 A select committee was set up in 1841 'to inquire into the State of the Laws respecting joint stock companies (except for Banking), with a view to the greater Security of the Public'; the committee came under the chairmanship of William Gladstone in 1843; and in 1844 the committee reported that there was need for legislation providing for registration of deeds of settlements with a public official. This was enacted in 1844 as 7 & 8 Vict c 110, and is the first of the modern *Companies Act*. References to the 'Act of 1844' connotes this statute.

necessary for carrying into effect the Purposes of such Company, and in all respects as other Partnerships are entitled to do.' However, 'company' as therein defined under the *Act of 1844* was still a partnership; and it was not subject to the doctrine of *ultra vires*. The intention of the legislature from 1856 onwards was for the capacity of a company to be defined and corralled by the simple specification of an unalterable object.

The word 'object' was undefined in the Act, but it seems to imply some notion of purpose[20] or the broad generic description of the company's business. The reported cases seem to draw a distinction between objects and powers. Power has been defined as 'a legal ability by which a person may create, change or extinguish legal relations',[21] a definition which does more to confound, rather than clarify, the word.

Some concession seems to have been afforded by *Farrar* who states that 'power is thus an aspect of capacity'; he goes on explain that 'power' is generally accepted to be less than an 'object' in the sense that by power one makes reference to 'means'; whereas by 'objects' one indicates the 'ends'.[22] This explanation is no better, but it has to do for the moment. The point is, anything outside the objects and powers[23] of a company was regarded as *ultra vires*.

However an *ultra vires* act was not considered 'illegal' as such, for Lord Cairns LC in the House of Lords decision in *Ashbury Railway Carriage and Iron Co Ltd v Riche*[24] said:

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20 *Farrar, 'Farrar's Company Law', 4th Ed., Butterworths 1998, p. 98, quoting Re Governments Stock Investment Co [1891] 1 Ch 649, at p 655.*

21 *Farrar*, supra, quoting *Seavey (1920) Yale LJ 859 at 861.*

22 *Ibid*, at p 98.

23 Ibid.

24 *Supra*

I have used the expressions *extra vires* and *ultra vires.* I prefer either expression very much to one which occasionally has been used in the judgements in the present case, and has also been used in other cases, the expression 'illegality'.

In a case such as that which your Lordships have now to deal with, it is not a question whether the contract sued upon involves that which is *malum prohibitum* or *malum se,* or is a contract contrary to public policy, and illegal in itself. I assume the contract in itself to be perfectly legal, to have nothing in it obnoxious to the doctrine involved in the expressions which I have used. The question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract.

Amelioration of the common law position – the 'fairly incidental to objects' test

Shortly after the Ashbury case, and possibly realising that its decision in Ashbury may have been too narrow, the House of Lords relaxed the ultra vires rule a little in *A-G v Great Eastern Railway Co*[25]. The Lords held that that in addition to the powers conferred by the memorandum, a company had power, even at common law, to do whatever could fairly be regarded as incidental to its objects. In *Great Eastern Railway Co,* the company had been incorporated by statute to acquire the undertakings of two existing railway companies and to construct and run certain other railways. The question before the court was whether it was within the company's powers, as defined by the incorporating statute (which for the purposes of this discussion, may be taken as equivalent to a memorandum of association) to hire out locomotives and rolling stock to another railway company operating in the same area.

Lord Selbourne LC said:

> I assume your Lordships will not now recede from anything that was determined in the *Ashbury Rly Carriage and Iron Co v Riche (1875) LR 7 HL 653.* It appears to me to be important that the doctrine of *ultra vires,* as it was explained in that case, should be maintained. But I agree with Lord Justice James that this doctrine ought to be reasonably, and not unreasonably, understood and applied, and that whatever may fairly be regarded as incidental to, or consequential upon, those things which the legislature has authorised, ought not (unless expressly prohibited) to be held, by judicial construction, to be *ultra vires* ...

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25 *(1880) 5 App Cas 473.*

His Lordship went on to hold that the activities in question were in any case within the company's express power.

Attempt of draftsmen to enlarge memorandum

Unhappy with the decision in *Ashbury*, and despite the amelioration of the *ultra vires* doctrine *in A-G v Great Eastern Railway Co*, businessmen conceived that they needed greater latitude in commerce; for they desired a company's capacity to be as unfettered as possible. Consequently there were various means by which draftsmen attempted to enlarge the memorandum; and a convenient device was resorted to: since the objects were to be expressly stated in the memorandum; and no act of the company could go beyond those objects, the very memorandum itself was made as wide as possible.

Clinging to some misplaced sense of rectitude, but forced to support these devices grudgingly, the judges mounted a rearguard action to propagate the doctrine.

On account of the creativity of the draftsmen, naturally, the size of the objects clause began to assume inflated proportions.

The courts took a rather a dim view of this; and the moralising – and even condescending – tone of the judiciary is manifest in the words of Lord Wrenbury in *Cotman v Brougham*[26]:

> There has grown a pernicious practice of registering memoranda of association which under the clause relating to objects contain paragraph after paragraph not specifying or delimiting the proposed trade or purpose, but confusing power with purpose and

[26] *[1918] AC 514, at 523 (HL).*

> indicating every class of act which the corporation is to have power to do. The practice is not one of recent growth. It was in active operation when I was a junior at the Bar. After a vain struggle I had to yield to it, contrary to my own convictions. It has arrived now at a point at which the fact is that the function of the memorandum is taken to be, not to specify, not to disclose, but to buy beneath a mass of words the real object or objects of the company, with the intent that every conceivable form of activity shall be found included somewhere within its terms.

Sir Francis Palmer in his *Company Precedents*[27] indicates that these were not views which were held universally:

> No doubt some persons have argued that what the Legislature really intended was that the principle objects should be specified – not the powers by which those objects are proposed to be attained – and proceeding from this premise maintain that once a main or primary 'object' is specified it is improper to set out in the memorandum further objects which merely confer 'powers'. But there is nothing in the Act to give colour to this contention, or to show an intention to discriminate between main objects and objects merely conferring powers. Every object stated, whether main or auxiliary, in effect endows the company with a power or powers. To exclude objects conferring powers is to nullify the Act.
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> Beside these critics there is another class who complain of what may be called the multifariousness of the contents of the memorandum of association. The objects clause according to their view ought to specify the leading objects, be they one or many, and that is enough! To go on and to specify as an object anything which is implied or may possibly be implied as incidental, on a reasonable construction of the leading object or objects, is irregular and improper. There ought to be no

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27 *Palmer's Company Precedents (11th Ed. 1912) vol. 1, pp. 458-9;* quoted by *Farrar, (supra)* at p 101.

> overloading, overlapping, repetition or surplusage. But here again the answer is that it is a matter of the subscribers' discretion.

As opposed to the sombre tones of Palmer, of more recent vintage is *Sealy's* pungent observation of the judiciary's attitude:[28]

> The judges saw it as their role to fight a rearguard action against these attempts to undermine the ultra vires doctrine. They protested frequently at the length and prolixity of the drafting – a futile gesture, and a rather unbecoming attitude for them to take, since most of them must, as counsel, have spent much professional time earlier on in their careers in drafting and settling the very terms which they now sought to condemn!

The rule in *Re Haven Gold Mining Co* – the 'main objects rule'

In order to overcome the growing prolixity of the objects' clause the courts evolved their own narrowing mechanism: and this device was known as the 'main objects rule'. This mode of construction was first put forth in 1882 by the Court of Appeal case of *Re Haven Gold Mining Co*.[29] Under this rule, where there exist numerous paragraphs which set out the avowed objects of a company, the courts seek for the paragraphs that appear to represent the 'main' or 'dominant' object; and thereafter treat all other clauses, no matter how generally or expansively worded, as mere ancillaries to the 'main' objects chosen by the courts; and in this way, limit their ambit.

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28 Infra, at p 148.

29 *(1882) 20 Ch D 151, CA.*

'Main' and 'independent' clauses

To the restrictions expressed in the *Re Haven,* the corporate community responded with typical innovative genius: they arranged the paragraphs of the objects clause in such a way that they conferred, by express words upon every one of the objects clause, the rank of a 'main' clause. The general effect of these kind of clause was that the objects as set out in the memorandum were not to be restrictively construed (i.e. 'non-restrictive construction clauses'); it also meant that each of the paragraphs in the memorandum was to be regarded as a separate and independent object.

Such clauses were not greatly appreciated by the judiciary, and in the case of *Stephens v Mysore Reefs (Kangundy) Mining Co Ltd*[30] Swinfen Eady J, rejected the efficacy of clauses which had the effect of stringing together wide powers.

The validity of 'main' and 'independent' or 'non-restrictive construction clauses' was again resurrected in the landmark House of Lords case of *Cotman v Brougham*.[31] In that case, the company was a rubber company which had an over-long objects clause, ending with the post *Re Haven* kind of provision. The company underwrote an issue of shares by an asphalt company. The validity of the act of underwriting could have been considered legitimate if the view was that the underwriting was a separate object – and indeed there it was so accepted, if with a great deal of reluctance. These clauses therefore came to be known as *'Cotman v Brougham'* clauses. The House of Lords felt unable to comment upon the validity of the objects clause because their Lordships felt that the Registrar's Certificate was conclusive that the formalities had been complied with; and the matter of the dispute was therefore completely out of the hands of the Law Lords. Lord Wrenbury expressed strong disapproval of such clauses, as

30 *[1902] 1 Ch 745*
31 *[1918] AC 514*

did numerous other members of the quorum. Soon these *Cotman v Brougham* clauses became standard form.

A power may not be converted into an object

Nevertheless in *Re Introductions Ltd*[32] the Court of Appeal took a restrictive, last-ditch stand. The company, in that case, had been incorporated to promote exhibitions during the Festival of Britain. Later, it tried its hand at pig farming, with disastrous results. A bank had loaned it money for the pig-breeding business. Upon the insolvency of the company the efficacy of the bank's loan was invoked. Unfortunately there had been no reference to pig farming in the objects clause. In order to validate the loan, and not to defeat the rights of the bank for repayment, it was necessary to argue that the borrowing clause had existed as an independent object, by virtue of the *Cotman v Brougham* type of clause. The Court of Appeal refused to sanction the argument; holding that the Cotman type of clause could not convert something which was intrinsically a power into an object; for borrowing has been, intrinsically, a power.

Other devices to beat the common law rule

In addition to the *Cotman v Brougham* type of clause, draftsmen resorted to three other devices.

The first preceded the leading objects in the memorandum with the words 'as an independent object. By the second device, they drafted the leading objects very widely indeed, casting a vast net.

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32 *[1970] Ch 1999*

There was a third device, one where the objects stated that the directors may carry-on any business which the company or the directors thought fit (or the 'subjective objects clause').

The efficacy of such a clause was accepted by the court in the case of *Peruvian Rlys Co v Thames and Mersey Marine Insurance, Re Peruvian Rlys Co.*[33] Cairns LJ said:

> Anything, therefore, which, in the opinion of the company ... is incidental or conducive to the main object of the company – which as the acquisition of concessions for railways – they may do.

In *Bell Houses Ltd v City Walls Properties Ltd.,*[34] the Court of Appeal approved of such a 'subjective objects clause'. One of the relevant objects clause of a property development company was one which indicated that, 'To carry on any trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to ... the general business of the company'. It was there emphasised that the transaction – which was the procurement of commission for introducing another company to financiers – was ancillary to the existing business.

These devices received the grudging support of judges; but the draftsmen did all they could to minimise effect of the *ultra vires* rule; and not without some success.

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33 *(1867) 2 Ch App 617 at 624.*

34 *[1966] 1 QB 207*

Corporate gifts, and related transactions – conceptual difficulties

A company is often called upon to make gratuitous payments to various relief bodies, e.g. hospitals, charities, pension funds etc. Social responsibility demands of it; but because the exercise of any one or more of these actions involve both the duties of the directors and the uncomfortable notion of falling foul of the objects clause, this raises fundamental questions about the underlying philosophy of the doctrine, and its relation to the actions of directors.

Nevertheless in *Hutton v West Cork Rly Co*[35], Bowen LJ remarked that there should be 'no cakes and ale except such as is required for the benefit of the company', and that 'charity has no business to sit at boards of directors *qua* charity'.

In *Re Lee Behrens & Co Ltd*,[36] three tests were laid down. Eve LJ said:

> Whether they be made under an express power, ... the validity of such grants is to be tested... by answers to three pertinent questions:
>
> (1) Is the transaction reasonably incidental to the carrying on of the company's business?
> (2) Is it a *bone fide* transaction? and
> (3) Is it done for the benefit of and to promote the prosperity of the company?

There are conceptual difficulties with the *Lee Behrens* test, and the three-pronged problem is lucidly explained by *Farrar:*[37] First, objects clauses in memoranda of associations are always express, whereas the first element of the *Lee Behrens* test is in respect of an 'implied power'. Secondly, ensuring that a

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35 *(1883) 23 Ch D 654, CA.*
36 *[1932] 2 Ch D 46.*
37 *Supra, at page 104.*

transaction is 'bona fide', as such, is an ingredient of the in common law fiduciary duties of the directors, and has nothing to do with the general concept of ultra vires, and the one ought not be confused with the other. Thirdly, the need to show a motive of 'benefit and prosperity' for the company is merely a natural extension of the combined effect of elements (1) and (2).

Notwithstanding the doctrinal complications it posed, the *Lee Behrens* test gained some ascendancy for a while, and has only recently been dealt with at appellate level.

In *Parke v Daily News Ltd,*[38] a company which proposed to close down its operation desired to make gratuitous payments to its redundant employees; a move urged on by the majority shareholder, one Cadbury. A minority shareholder challenged this proposal, and the matter came before Plowman J, who applied the *Lee Behrens* test, holding that the proposed payments were ultra vires.[39]

The three pronged test was also applied in *Re W & M Roith Ltd.*[40] There, a director, who had taken ill, entered into an agreement with the company, making provisions for his wife after his death; and the agreement was held to be ultra vires. That it may not have been an ultra vires case at all, but one which concerned the breach of duty of the director, was not considered in that case, and the decision there may be indefensible for this reason.

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38 *[1962] Ch 927.*

39 The immediate effect of *Parke* was negated UK labour legislation. Two provisions in CA 1985 are of interest. *Section 309* enables directors to have regard to the interests of the shareholders and employees; while *s 719* grants powers to the company to provide for employees in the event of the transfer, or cessation of business.

40 *[1967] 1 All ER 247.*

The *Lee Behrens* test met its Waterloo, as it were, in the case of *Charterbridge Corpn Ltd v Lloyds Bank Ltd.*[41] The principle to be extracted from that case is this: the state of mind of those acting on behalf of a company – for example it directors – is wholly irrelevant to the question of capacity. This case involved a matter of a group of companies granting a guarantee to a bank in consideration of the bank releasing finance to one of the subsidiaries for the purpose of property development. In the memoranda of each of the constituent companies in the group there existed an express clause, providing for the giving of guarantees. The issue was whether the guarantees given by each of the subsidiaries in the group were *ultra vires.*

Pennycuick J rejected the *Lee Behrens* test on two alternative grounds: the first was the existence of the express objects clause, which of course put paid to the *ultra vires* argument. The second ground was that it was not necessary for the court to examine whether or not the directors had considered the act to be for the good of the company; it was sufficient, the court said, if a reasonable director, standing in the shoes of all the directors, would have believed that it was for the good of the company.

Farrar[42] seems to have acknowledged this as a defensible decision, in spite of the fact that the learned judge there had not considered both the *Parke* and *Roith* decisions; but what is difficult to reconcile is the test itself in *Charterbridge;* it smacks of simply re-stating the *Lee Behrens* test in another way. How is it possible for a director, in all sincerity, to 'believe' that the transaction was 'good for the company' if he had not examined it in good faith (the 'bona fide' limb) and if the transaction in question was not for the economic betterment of the company (the 'benefit of and to promote the prosperity' of the company limb)?

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41 *[1970] Ch 62.*

42 *Supra, at p 104.*

This question is largely unanswered, but it is noteworthy that the later Court of Appeal case of *Re Horsley & Weight Ltd,*[43] where Buckley LJ said that the objects of the company need not be commercial; they could be charitable or philanthropic or 'whatever the original incorporators wished', provided they were legal – some of this will later be adverted to; for the moment one must pass on to the general trend of development in judicial thinking inspired by the dichotomy in the *Lee Behrens* and *Charterbridge* cases.

Decided just before *Charterbridge*, the Court of Appeal in *Re Introductions Ltd*[44] held that some powers – the power to borrow for instance – may be construed by the court as 'incidental' powers, even though declared by the memorandum to be 'objects'.

Charterbridge was followed in Scotland in *Thompson v J Barke & Co (Caterers) Ltd,*[45] and in England in *Re Halt Garage (1964) Ltd.*[46]

In *Re Halt Garage,* Oliver J added a interpretation that muddied the waters even further – it was all a question of etymology. His Lordship said that once a transaction was *intra vires,* the proper test lay in the genuineness and honesty of the transaction. He felt that the relevant question was: 'was it a genuine exercise of power?', and not some allegedly abstract notion of 'is it to the benefit of the company?' Thus he said, if claims were made for remuneration, the real question that ought to be asked was, 'are the payments in question genuine remuneration?'

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43 *[1982] Ch 442, [1982] All ER 1045*
44 *[1970] Ch 99, [1969] 1 All ER 887*
45 *1975 SLT 67.*
46 *[1982] 3 All ER 1016*

The learned judge did not explain whether, all cases of a 'genuine exercise of power' would, as it were, automatically give rise to the transaction being rendered *intra vires;* or whether, as he suggested, the test ought to be applied at three levels. At the first level one had to determine whether the transaction was in fact *intra vires.* If it was, then one has to proceed to the second level, to consider whether it was a case of a 'genuine exercise of power'. If the alleged exercise of power passed both limbs of the test; then one was finally to determine whether a certain act had not fallen out of the *ultra vires* doctrine.

Despite all these ventilations, the case did not elucidate the poor distinction between powers and objects.

The learned judge does however makes concession to this difficulty in these words:

> I cannot help thinking ... that there has been a certain confusion between the requirements for a valid exercise of the fiduciary powers of directors (which have nothing to do with the capacity of the company but everything to do with the propriety of acts done within the that capacity),[47] the extent to which powers can be implied or limits placed ... on express powers, and the matters which the court will take into consideration at the suit of the minority shareholder in determining the extent to which his interests can be overridden by a majority vote. These three matters ... raise the questions which are logically quite distinct but which have sometimes been treated as if they demand a single, universal answer leading to the conclusion that, because a power must not be abused, therefore, beyond the limit of propriety it does not exist.

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47 This observation is naive.

Re Horsely examined this matter further. The question that arose there for determination was whether a pension policy for a director and employee was ultra vires; and whether this had amounted to a misfeasance by the director in the liquidation of the company. The court took the view that there was an express provision for the grant of pensions and that constituted a 'substantive object', and not a mere ancillary power. It was also expressed emphatically that the prosperity and the benefit to the company were immaterial; the efficacy of the *Lee Behrens* and *Roith* tests were doubted. The *dicta* in *Charterbridge* was however, approved. Buckley LJ said that the objects of a company need not be commercial, they could even be charitable, or philanthropic, or whatever the incorporators desired, so long as the object was legal. A company which has such philanthropic or charitable objects could therefore part with its funds for those purposes.

All three Appeal judges were of the view that the scope of any paragraph in the objects clause was a matter of construction.

Rolled Steel Products (Holdings) Ltd v British Steel Corporation – breaking new ground

The construction point was elaborated in the famous case of *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*.[48] The principle there laid down was that an act which comes within the scope of a power conferred expressly or impliedly by the constitution is not beyond the company's capacity by reason of the fact that the directors entered into it for some improper purpose.

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48 *[1982] Ch 478, [1982] 3 All ER 1057.*

The issue in question was the validity of a guarantee and debenture given by a company in excess of the company's own indebtedness and which stood to benefit others. The objects clause did preserve an express power to advance money.

The Court of Appeal re-stated the law in this way: A clear distinction ought to be drawn between transactions which are beyond the capacity of a company from those which are in excess or an abuse of the powers of the directors; the term 'ultra vires' connotes, and should be reserved for the former. The question of capacity of a company is a matter of true construction of the memorandum. Although the general rule is that each provision of the memorandum is to be given its full effect; any one provision, whether by its words or otherwise may be incapable of constituting a 'substantive' object. The very nature of the clause, for instance, might indicate that it was a mere ancillary power in relation to other objects. However, where, to outward appearances, a particular transaction was capable of being performed as something reasonably incidental to the attainment of the pursuit of the company's objects, it will not be rendered *ultra vires* merely because the directors entered into it for purposes other than those indicated in the memorandum.

The relevant passage of the judgement of Browne-Wilkinson LJ is here reproduced:

> ...
>
> The critical distinction is therefore, between acts done in excess of the capacity of the company on the one hand and acts done in excess or abuse of the powers of the company on the other. If the transaction is beyond the capacity of the company it is in any event a nullity and wholly void; whether or not the third party had notice of the invalidity, property transferred or money paid under such a transaction will be recoverable form the third party. in, on the other hand, the transaction (although in

excess of abuse of powers) is within the capacity of the company, the position of the third party depends upon whether or not he had notice that the transaction was in excess or abuse of the powers of the company. As between the shareholders and the directors, for the most purposes it makes no practical difference whether the transaction is beyond the capacity of the company or merely in excess or abuse of its powers: in either event the shareholders will be able to restrain the carrying out of the transaction or hold liable those who have carried it out. Only if the question of ratification by all the shareholders arises will it be material to consider whether the transaction is beyond the capacity of the company since it is established that although all the shareholders can ratify a transaction within the company';s capacity, they cannot ratify a transaction falling outside its objects.

...

For these reasons, in considering a claim based on ultra vires, the first step must be to determine what are the objects (as opposed to the powers) of a company. Not all activities mentioned in the objects clause are necessarily objects in the strict sense; some of them may only be capable of existing as, or on their true construction are, ancillary powers: *Cotman v Brougham* and *Re Introductions Ltd.* And this may be the position even if the memorandum of association contains the usual 'separate objects' clause: such a clause is not capable of elevating into an object of the company that which is in essence a power: see *Re Introductions Ltd.*

If, on construction of the objects clause, the transaction falls within the objects (as opposed to the powers), it will not be ultra vires since the company has the capacity to enter into the transaction. If the objects clause contains provisions (whether objects or powers) which show that a transaction of the kind in question is within the capacity of the company, that transaction will not be ultra vires...

...

Applying those principles to the present case, in my judgment, no question of ultra vires arises.

(SLADE and LAWTON delivered concurring judgments).

There are some difficulties with this judgements which deserve mention: The distinction in *Re Introductions Ltd* between a substantive power and a 'mere' power lost a lot of ground as a result of *Rolled Steel,* but the decision in *Re Introductions Ltd* itself would remain relevant to the question of whether the directors have exceeded or abused their corporate powers. A ruling by the court that a particular act is within the objects of the company, rather than its powers – as it transpired in the *Re Horsley* case – may strengthen the directors' case but will not, according to *Sealy,* be conclusive of the issue.[49]

The second difficulty is that throughout the judgement in *Rolled Steel* the court of appeal refers to 'ratification' by the 'unanimous' consent of the shareholders. In cases like *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd*[50] and *Re Horsley,* consent had been granted in an informal manner.

In those two cases the requirement for consent, therefore, had to be unanimous. However, it is not clear whether in *Rolled Steel* the Court of Appeal had, at the back of their minds, those cases or whether they were laying down a new principle, in fact requiring 'unanimous' consent. In two cases, *North-West Transportation Co Ltd v Beatty*[51] and *Bamford v Bamford,*[52] it had been held that

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49 *Supra, see p 172, Notes.*
50 *[1983] Ch 258.*
51 *(1887) 12 App Cas 589.*
52 *[1970] Ch 212, [1969] All ER 969*

a resolution validly passed by a majority vote at a general meting would be effective ratification.

Thirdly, no mention is made in *Rolled Steel* about *Re Jon Beauforte (London) Ltd* which must surely be considered as an example of the operation of *ultra vires* at its worst; a case for the way in which the 'constructive notice' doctrine was applied to produce an inequitable result.[53]

In this way then, the confused jangle of rules constituting this doctrine became so enmeshed in its own variations, and its lack of distinction in the objects/powers debate so obtuse, that it became increasingly obvious that something had to be done to change the law, and to the reformation of the doctrine we must now turn.

53 That case is not longer authoritative in view of *s 35, CA 1985.*

Chapter 2

REFORM OF THE *ULTRA VIRES* DOCTRINE IN ENGLISH LAW

Introduction

The *ultra vires* doctrine, absolute in its terms and disastrous in its consequences came to strike like a virus: randomly, infrequently and sometimes with devastating consequences. It became after a while a hazard for the very people who it had sought to protect—the shareholders.

One needed to look no further than the first instance decision in *Bell Houses Ltd v City Wall Properties*.[54] In that case the defendant agreed to pay the sum of £20,000 to the plaintiff if the plaintiff agreed to introduce the defendant to a financier for a loan of £1 Million. The plaintiff did make the introduction successfully, the loan was granted; but the defendant refused to pay the plaintiff fee of £20,000, contending that any agreement it made with the Plaintiff to remunerate the Plaintiff for mortgage-broking transactions was in fact *ultra vires* the objects of the Defendant company. The fist instance judge, Mocatta J, agreed, and the plaintiff lost the bargain. The decision was reversed at the Court of Appeal; but the point is this—the doctrine did not protect the very people it was supposed to protect i.e. shareholders and creditors.

A second example where a creditor was prejudiced was in the case of *Re Jon Beauforte (London) Ltd*,[55] where the company memorandum authorised it to

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54 *[1966] 2 QB 656, [1966] 2 All ER 674*

55 *[1953] Ch 131, [1953] 1 All ER 634 (Chancery Division)*

carry on the business of costumiers and gown-makers. The company decided to undertake the business of making veneered panels. A supplier of coke delivered coal to the premises of a factory set up in Bristol for express purpose of making veneered panels. The company was wound-up; a proof of debt of The memorandum contained a 'subjective' objects clause—of the sort which was in fact favourably received in the *Bell Houses* case—but here, in *Re Jon Beauforte* the court held that the purpose of making veneered panels was *ultra vires* the company. Counsel for the coke supplier argued that the coke could have been used as fuel for heating purposes, for the supplier had no idea what the terms of the memorandum were.

The case of its abolition was therefore thought to be long overdue.

The Cohen Report

In June 1945 a law reform committee under Mr. Justice Cohen was established with a view to making recommendations to the Government of the day. The Cohen Committee reported that:[56]

> 11. **Existing provisions-** ... The memorandum of a company defines its objects and a company's objects are limited to those expressly mentioned and such as are ancillary to the expressed objects. A contract made by the directors upon a matter not within the ambit of the company's objects is *ultra vires* the company, and, therefore, beyond the powers of the directors. This principle is intended to protect both those who deal with the company, and its shareholders.

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56 Report of the *Committee on Company Law Amendment ("Cohen Report") June 1945, pp. 9-10, Cmnd 6659*

12. **Doctrine of *ultra vires*-** Had memoranda of association closely followed the forms in the First Schedule to the Act, this protection might have been real, but, partly with a view to obviating the necessity of applying to the Court for confirmation of an alteration of objects, a practice has grown up of drafting memoranda of association very widely and at great length so as to enable the company to engage in any form of activity in which it might conceivably at some later date wish to engage and so as to confer on it all ancillary powers which it might conceivably require in connection with such activities. In consequence the doctrine of *ultra vires* is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the Company. For example, if a company which has not taken powers to carry on at taxi-cabs to the company or who have been employed to drive them, may have no legal right to recover payment from the company. We consider that, as now applied to companies, the *ultra vires* doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation. **We think that every company, whether incorporated before or after the passing of a new Companies Act, should, notwithstanding anything omitted from its memorandum of association, have as regards third parties the same powers as an individual.**[57] Existing provision in memoranda as regards the powers of companies had any like provisions introduced into memoranda in future should **operate solely as a contract between a company and its shareholders as to the powers exercisable by the directors.**[58] In our view it would then be a sufficient safeguard if such provisions were alterable by special resolution without the necessity of obtaining the sanction of the court, subject in cases where debentures have been issued before the coming into force of a new Act, to the consent of the debenture-holders by extraordinary resolution passed at a meeting held under the provisions contained in the trust deed or (in the absence of such provisions) convened by the Court.

Unfortunately the Cohen Report's recommendations were not taken up by the UK government. By *section 5* of the *1948 Act* qualified effect was given to the

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57 We can see how this must have influenced the formation of *s 162* of the *Australian Corporations Law*, which confers the capacity of a natural person upon a company.

58 This 'internal consequence' principle is seen in the wording of *s 20(2)* of the *Malaysian Companies Act 1965.*

Cohen Committee's recommendations as to the alteration of objects clauses by special resolution without the sanction of the Court; but nothing was done to implement their recommendation as to the abolition of the *ultra vires* doctrine.[59]

The reason for this is stated by the Jenkins Committee:[60]

> 38. The memorandum of evidence submitted by the Board of Trade in the present inquiry gives the following reasons for this omission:-
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> "When the bill amending the 1929 Act was being prepared, the Board were advised that it would not be simple operation to give effect to this suggestion of the Cohen Committee. A third party might find himself unable to enforce a contract against a company either on the ground that it was outside the scope of the company's objects or on the ground that it was beyond the authority of the directors. In both cased he would be affected with notice of the limits imposed by the objects, clause of the company's memorandum which was a public document. Merely to abrogate the *ultra vires* rule in relation to the company would in practice leave the third party no better off, since the objects clause would still affect him with notice of the limits on the authority of the directors. Nor would it be likely to reduce the prolixity of modern memoranda, since directors would have a strong incentive to protect themselves by procuring the company to extend the authority given them by the object clause. To give effect to the suggestion of the Cohen Committee it would therefore be necessary to modify, if not to abrogate, the rule that the memorandum is a public document, of which third parties dealing with the company are deemed to have notice, In view of the prevailing pressure of work and the need for rapidly implementing the main recommendations of the Cohen Committee the Board decided that they would not be justified in holding up the

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59 As recalled by the *Jenkins Report at paragraph 37, Cmnd 749.*

60 *Ibid.*

preparation of the Bill in order to work out what appeared to them to be a far-reaching change which might involve highly complicated drafting".

Thus the Government at the time had recognised that to abrogate the *ultra vires* principle without at the same time modifying the rule that all persons dealing with a company were deemed to have constructive notice of its memorandum, (or what is known as 'constructive notice' principle) would be pointless; for the other party to a contract would still be deemed to know that the *directors* has no *authority* to contract with him in a matter not covered by the objects clause. The constructive notice rule was thought far too important to jettison. So the new *1948 Act* left the *ultra vires* doctrine intact.

The Jenkins Report

There was a wait of more than 17 years; after which a law reform committee headed by Lord Jenkins sought the reform of the doctrine.[61] Having considered the difficulties, the Jenkins Report concluded:

> 40. Difficulties such as these lead us to conclude that the change in the law involved in the proposed attribution to companies of all the powers of a natural person ought not to be lightly adopted, and we see not sufficiently cogent reason for adopting it. The evil sought to be cured is the injustice wrought to third parties who have entered into and acted on contracts with a company which are afterwards discovered to be *ultra vires* the company. This source of injustice, however, has been to a great extent eliminated by the use of the wide forms of objects clause referred to in the Cohen Committee's report, and instances in which injustice has in fact been brought about by the *ultra vires* rule seem of late years to

61 *Report of the Company Law Committee (Jenkins), June 1962, (Page 10 - 13), Cmnd1749*

have been rare, the most recent example cited to us being that of *In re Jon Beauforte (London) Ltd. [1953] Ch. 131.*

41. In these circumstances it seems to us that the best course will be to attempt no general repeal of the existing law of *ultra vires* in relation to companies registered under the Companies Acts but to provide protection to third parties contracting with companies (i) against the unfair operation of the *ultra vires* rule and (ii) by abrogating the rule, already mitigated by the decision in *Royal British Bank v Turquand , (1855) 5E & B. 248, (1856) 6 E, & b., 327,* that third parties are fixed with constructive notice of the contents of a company's memorandum and articles of association.

The Jenkins Committee then made the following recommendation:

42. We recommend that:-

(a) a contract entered into between a company and another party (including a shareholder contracting otherwise than in this capacity as a shareholder) contracting with the company in good faith should not be held invalid as against the other party on the ground that it was beyond the powers of the company: he should not , however, be allowed to enforce the contract without submitting to perform his part of is parts of it so far as it is unperformed;

(b) in entering into any such contract the other party should be entitled to assume without investigation that the company is in fact possessed of the necessary power; and should not be by reason of his omission so to investigate be deemed not to have acted in good faith, or be deprived of his right to enforce the contract on the ground that at the time of entering into it he had constructive notice of any limitations on the powers of the company, or on the powers of any director or other person to act on the company's behalf, imposed by the memorandum or articles of association;

(c) the other party should not be deprived of his right to enforce the contract on the ground that he had actual knowledge of contents of the memorandum and articles at that time of entering into the contract if he honestly and reasonably failed to appreciate that they had the effect of precluding the company (or any directors or other person on its behalf) from entering into the contract in question;

(d) there should be no change in the position of the company in relation to *ultra vires* contracts entered into by it.

Rather oddly the Jenkins did not urge the abolition of the *ultra vires* doctrine itself. The Jenkins Report was not acted on, however. However, nations all around the Commonwealth took steps to discard both doctrines by one technique or another.[62]

Article 9 of the First EC Company Law Directive

Then in 1972, the United Kingdom acceded to the *Treaty of Rome*. Because of the Treaty, it became necessary for United Kingdom to modify the doctrines of *ultra vires* and the law relating to constructive notice, in order to comply with *Article 9* of the *First EC Company Law Directive*. That Directive was in these words:

The First EC Directive

First EC Council Directive No 68/151/EEC

62 Such as enacting comprehensive lists of statutory objects applicable to all companies, declaring companies to have the full legal capacity of a natural person, allowing 'unlimited objects' clauses, making the objects clause optional, and even (in the case of the Isle of Man) banning the registration of objects clauses altogether.

ARTICLE 9

1 Acts done by the organs of the company shall be binding upon it even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs.

However, Member States may provide that the company shall not be bound where such acts are outside the objects of the company, if it proves that the third party know that the act was outside those objects or could not in view of the circumstances have been unaware of it; disclosure of the statutes1 shall not of itself be sufficient proof thereof.

2 The limits on the powers of the organs of the company, arising under the statutes or from a decision of the competent organs, may never be relied on as against third parties, even if they have been disclosed.

3 If the national law provides that authority to represent a company may, in derogation from the legal rules governing the subject, be conferred by the statutes on a single person or on several persons acting jointly, that law may provide that such a provision in the statues may be relied on as against third parties on condition that it relates to the general power of representation; the question whether such a provision in the statues can be relied on as against third parties shall be governed by Article 3.2

Article 9 was concerned to protect outsiders dealing with a company, by ensuring that they were not disadvantaged by a company which was acting beyond its capacity.

This motive was effected by *s9(1)* of the *European Communities Act 1972.*

Section 9(1) of the European Communities Act 1972

Section 9(1) was in these words:

> **European Communities Act 1972**
>
> **s9 Companies Act 1985**
>
> (1) In favor of **a person dealing with a company in good faith**, any transaction **decided on by the directors** shall be deemed to be one which it is within the capacity of the company to enter into, and the power of the directors to bind the company shall be deemed to be free of any limitation under the memorandum or articles of association; and a party to a transaction so decided on shall not to be bound to enquire as to the capacity of the company to enter into it or as to any such limitation on the powers of the directors, and shall be presumed to have acted in good faith unless the contrary is proved.

Section 9 of the *European Communities Act 1972* was, in it s original form, later consolidated in the United Kingdom as *section 35 CA 1985.*

However, the drafting of the provision left much to be desired. It was defective in a number of respects. For instance, it was expressed to apply only to transactions which were 'decided on by the directors'. It had another flaw, for it operated only in favour of third parties 'acting in good faith'. Thus the company itself could not invoke *s 9 (or s 35 CA 1985)* for its own benefit. It was acknowledged that the object of the reform was 'to implement the requirements

of the Directive, and no more';[63] and arguably the section did not achieve even that.[64]

The result was most unsatisfactory: the brutal effects of the *ultra vires* doctrine were apparently partially avoided, but the doctrine itself was allowed to survive, and stumble on.

The Prentice Report and s 35 CA 1985

In 1986, some four decades after the Cohen Report and twenty years after the Jenkins Report, a law reform committee headed by an Oxford Professor, Prentice, published its report in 1986.

As a result of the Prentice Report, *s 35 of CA 1985* was, pursuant *s 108 CA 1989*, recast in order to prevent the validity of any act done by a company from being called into question on the ground of lack of capacity.

The amended s 35 is in these words:

Companies Act 1985 (as amended by CA 1989, s 108

35 A company's capacity not limited by its memorandum

(1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum.

(2) A member of a company may bring proceedings to restrain the doing of an act which but for subsection (1) would be beyond the company's capacity; but no such proceedings shall

63 *LS Sealy, Cases and materials in Company Law*, 1996, 6th Ed, p 149.

64 *G Morse (1978) 3 EL Rev 60.*

lie in respect of an act to be done in fulfillment of a legal obligation arising from a previous act of the company.

(3) It remains the duty of the directors to observe any limitations on their powers flowing from the company's memorandum; and action by the directors which but for subsection (1) would be beyond the company's capacity may only be ratified by the company by special resolution.

A resolution ratifying such action shall not affect any liability incurred by the directors or any other person; relief from any such liability must be agreed to separately by special resolution.

Present position

However once again, the doctrine of *ultra vires* was not abolished: it survives, to this day, for some internal purposes. For example, under *s 35(2)*, a shareholder could bring proceedings to restrain the doing of an act which—but for subsection (1) —would be beyond the company's capacity. However, under *subsection (2)*, no such proceedings could be commenced in respect of an act to be done in fulfillment of a legal obligation arising from a previous act of the company.

In England, the doctrine also continues to apply to charitable companies[65] and to bodies not governed by the *Companies Acts* such as municipal corporations, industrial and provident societies, building societies and friendly societies.

The sundering of the traditional connection between a company's objects clause and its capacity does not, however, mean that those acting on behalf of the company will now have *carte blanche* to do as they like in the company's name.

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65 *s 35(4)*

A member always had, in the past, a right to go to court to seek an injunction to prevent his company from entering into what would have been an *ultra vires* transaction. Such a right of a member is now codified and preserved in the new s 35(2).[66]

The next subsection, s35(3), declares it to be the duty of directors to observe any limitations on their powers flowing from the company's memorandum; and this is reinforced by a double-limbed provision relating to ratification. First, the act itself is now made capable of ratification, in contrast with the common law rule of non-ratifiability, but a *special* resolution from liability arising from a breach of this duty must also take the form of a special resolution, which must be separate from that effecting the ratification.

CA 1985, s3A

One further reform effected by *CA 1989* was the enactment of a new provision, *CA 1985, s3A*, designed to encourage companies having commercial objects to abandon the traditionally voluminous objects clause. It provides that where a company's memorandum states that the object of the company is to carry on business as a general commercial company, (a) the object of the company is to carry on any trade or business whatsoever, and (b) the company has power to do all such things as are incidental or conducive to the carrying on of any trade or business by it. It was a well-meaning attempt to encourage the draftsmen of company memoranda to abandon the traditional long-winded objects clause. The draftsmen appear to be nonplussed. Many have sought to have the best of both worlds, by continuing to use their old lengthy precedents, and adding a further

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[66] Subject to a proviso for the benefit of third parties where the company is already committed by a legal obligation to perform the act in question.

clause listing the carrying on of business as a general commercial company as an additional object.

After the passing ultra vires, a clamour for other weapons

Although one may regard the doctrine of *ultra vires* doctrine as being for most purposes as 'dead law',[67] one cannot ignore its all-pervasive influence in the shaping of English company law and its philosophy. A reference to *Guinness v Land Corpn of Ireland Ltd*,[68] for instance (articles to be construed as subordinate to memorandum), or *Trevor v Whitworth*[69] (maintenance of capital), to realise that the same reasoning which gave rise to the *ultra vires* doctrine underpins many other principles which continue to be of central importance to the subject. It is unlikely that English company law will discard these related doctrines now that it has no use for the *ultra vires* rule.

Dissipation of corporate assets[70]

Even in the days when *ultra vires* had lost most of its sting, it remained the most potent weapon in the armoury of the courts against the irresponsible dissipation of corporate assets, and example of which is the case of *International Sales and*

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67 *LS Sealy, Cases and materials in Company Law*, 1996, 6th Ed, p 150.

68 *(1882) 22 Ch D 349*

69 *(1887) 12 App Cas 409*

70 *A Clark, 'Ultra vires after Rolled Steel Products' (1985) 6 Co Law 155*, and the note by *F Dawson* on the Australian case *ANZ Executors and Trustee Co Ltd v Qintex Australia Ltd* (1990) *8 ACLC 980 (Full Ct), (1991) 107 LQR 202.* Nourse LJ in *Brady v Brady [1989 AC 755* held that to bring a transaction involving financial assistance within the exception created by *s 153(1)(a), (2)(a),* a company's 'principal purpose' or 'larger purpose' must be something more than the reason why the transaction was entered into). In *Aveling Barford Ltd v Perion Ltd [1989] BCLC 626,* it was held that a sale at an undervalue made by a company to one of its shareholders (or to another company controlled by him) may be open to challenge on the ground that it is not a genuine sale but a disguised return of capital. Harman J in *Barclays Bank plc v British Commonwealth Holdings plc, [1996] 1 BCLC 1.* Harman J observed at p 17 that *'as it seems to me it must ... be unlawful to make an arrangement expressed to impose liability to make a gratuitous payment, that is, one not for the advancement of a company's business nor made out of distributable profits, at a future date when in the event the company has no distributable profits'.*

Agencies Ltd v Marcus.[71] The problem which these cases highlight are unlikely to slink away with the demise of the *ultra vires* doctrine.

After *CA 1989* has abolished the doctrine of *ultra vires*, the courts have now been deprived has deprived of the most potent of their traditional weapons when dealing with allegations that corporate property has been misapplied.[72] Judges will now have to have recourse to other less well tried rules and concepts, and perhaps invent some now ones, to cope with this problem.

With the gradual erosion of the doctrine, the occasions on which the doctrine could be successfully invoked were destined to become rather fewer - particularly after the Court of Appeal's ruling in the *Rolled Steel Products (Holdings) Ltd v British Steel Corpn.*[73] However, it was used with considerable effect to deal with the most manifest cases of misappropriation.[74]

An example of this can be seen in cases dealing with the dissipation of corporate assets. In such cases, with the demise of the ultra vires doctrine, the courts now employ other weapons in their armoury. It may be possible to show that directors have behaved unconstitutionally, exceeded their authority, abused their powers or acted in breach of their fiduciary duties, with the consequence that the relevant transaction may be declared void or voidable. Both the directors and any third person who has received corporate assets with knowledge of the circumstances are liable to reimburse the company.[75] If the third party has dealt in good faith, for value and without notice of the irregularity, the company's remedy against him will, of course, be lost.

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71 *[1982] 3 All ER 551*

72 *LS Sealy, Cases and materials in Company Law*, 1996, 6th Ed, *p 415*

73 *[1986] Ch 246, [1985] 3 All ER 52 (Court of Appeal)*

74 Such as *International Sales and Agencies Ltd v Marcus [1982] 3 All ER 551, [1982] 2 CMLR 46 (QBD).*

75 *Selangor United Rubber Estates Ltd v Craddock (No 3) [1968] 1 WLR 1555, [1968] 2 All ER 1073 (Chancery Division)*

There are other kind of breaches: for example a formal or informal breaches of directors' duty are not capable of ratification.[76] In other cases the power to ratify is restricted by statute.[77] Where the act involves illegality[78] it will not be capable of ratification at all.

So the courts are still relatively well equipped to deal with cases of wrongful depletion of corporate assets.

Having thus dealt briefly with the main points on Reform of the doctrine of *ultra vires*, it is necessary to look into the principle of constructive notice.

The rule as to Constructive Notice and its Abolition

The House of Lords in *Ernest v Nicholls*[79] ruled that a person dealing with a company should be deemed to have notice of that company's registered constitutional documents. That case established a doctrine that was later to be labelled 'constructive notice'. The case itself concerned a deed of settlement company incorporated by registration under the Act of 1844, but the principle which it enunciated was applied to companies formed with a memorandum and articles of association. Thus anyone dealing with a company was deemed to have notice of the contents of its memorandum and articles.

But once limited liability became the norm, the real trading risk shifted from the shareholders to the creditors, and the constructive notice doctrine ceased to have

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76 *Cook v Deeks [1916] 1 AC 554 (Privy Council), Kinsela v Russell Kinsela Pty Ltd (1986) 10 ACLR 395 at 401.*

77 *CA 1985, s 35(3));*

78 For example a prohibited distribution under *s 263 CA 1865* , or a breach of the 'financial assistance' prohibition under *s 151 CA 1985.*

79 *(1857) 6 HL Cas 401* t

any proper justification. Businessmen need to make decisions promptly and for them the documents held by the registrar are accessible only at too great a cost in time and trouble. But for so long as the doctrine remained in place, there was a risk that it could be invoked against them, sometimes with patently unjust results.[80]

The presumption of notice applied in the first place to the company's memorandum and articles, and to at least some special resolutions.[81] It was later extended to apply to the particulars of registered charges. The rule created many uncertainties, and due to its unpopularity, and the invidious results of its application, most jurisdictions have abolished the constructive notice rule altogether

The reforms introduced by *CA 1989* were no doubt intended to give effect to the Prentice recommendations and abolish the doctrine once and for all; but unhappily they have given rise to a great deal of uncertainty. Instead of a single provision consigning the rule to oblivion categorically and without qualification, the English draftsman has catered for it in three places *s 416, CA 1985* , *ss 35B* and *711A*.

Under *s 35B*, a party to a transaction with a company is not bound to enquire as to whether it is permitted by the company's memorandum or as to any limitation on the powers of the board of directors to bind the company or authorise others to do so.

Section 711A reads as follows:

711A Exclusion of deemed notice

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80 For example in the case of *Re Jon Beauforte (London) Ltd [1953] Ch 131, [1953] 1 All ER 634 (Ch D).*

81 *Irvine v Union Bank of Australia (1877) 2 App Cas 366, PC*

(1) A person shall not be taken to have notice of any matter merely because of its being disclosed in any document kept by the registrar of companies (and thus available fore inspection) or made available by the company for inspection.

(2) This does not affect the question whether a person is affected by notice of any matter by reason of a failure to make such inquiries as ought reasonably to be made.

However, there will be no further discussion on this point, for it raises other issues not relevant to our present purposes.[82]

Conclusion

In this Chapter we have seen the reformation of the law relating to the doctrine of *ultra vires* in England, and see how despite the recommendations of Cohen, Jenkins and Prentice Reports respectively, the reforms have not completely abolished the doctrine of *ultra vires*. We have also seen how the courts have lost the doctrine as a weapon to curtail executive indiscretions, particularly in the area of dissipation of corporate assets. We also observed the rise and fall, but not the death, as it were, of the principle of constructive notice.

Next we turn to consider two related matters. The first is the law of *ultra vires* as it applies to Malaysia; and thereafter at Chapter 4 there will be a discussion of some principles, which are unrelated and distinct from, but have, in Malaysia, often occurred alongside arguments as to *ultra vires*.

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82 Suffice it to say LS Sealy observes that 'whereas s 35B is not expressly made subject to any qualification, the question-begging language of s 711A(2) is capable of being construed in such a way as largely to take away whatever benefit is conferred by s 711A(1). Subsection (2) may have been intended only to deal with the case where a person turns a 'Nelsonian' blind eye, or to preserve the former law where someone has been 'put on inquiry', but the vague wording gives no real clue as to what is intended. In consequence, there has been much uncertainty as to the scope of the reforms which CA 1989 has actually brought about. It would seem reasonable to say that s35B should be treated as self-standing and that its clear words ought not to be read down by introducing into that section the qualification imposed by s 711A(2): in other words, that so long as the point at issue involves only *restrictions imposed by the company's memorandum* or *limitations on the powers of the board* to bind the company or authorise others to do so, no 'further inquiries' need to be made. But it appears that those who in the past have been in the habit of making thorough searches and inquiries before concluding transactions with companies - notably solicitors and banks - are not yet persuaded that the new law has made it safe for them to discontinue this practice.'

CHAPTER 3

THE DOCTRINE OF *ULTRA VIRES* IN MALAYSIA

Introduction

This chapter discusses the state of the doctrine *ultra vires* in Malaysia. For a start, there will a discussion of the common law position, and then an explanation of the legislative provisions in the *Companies Act 1965* related to object clauses, the relief they provide and their relationship to other provisions within the *Companies Act 1965.* Finally there will be a discussion of decided cases, scarce as they are, and how the courts have applied the legislative provisions and the judges approach to, and reliance on, common law principles of English origin. The complexities arising from the statutes and case law is superficially dealt with in this chapter. A deeper discussion of the doctrine and its effects (or lack thereof) on other associated, but unrelated principles to the doctrine of ultra vires will be taken up in *Chapter 4.*

The law relating to *Ultra vires* in Malaysia, enshrined in *Section 20* of the *Companies Act 965,* in fact follows the now repealed Australian *Uniform Companies' Act 1961.* The Malaysian legislative provision has existed for some four decades now, but in its applications the courts have struggled to extricate themselves from a mesh of old English principles.

The local position has not, however, advanced as far as Australia; who have raced well away from the other jurisdictions in the Commonwealth by the passing of the *Corporations Law,* and this is a matter that is dealt with at *Chapter 5.* Despite its

Australian origin, Malaysian law, in this respect at least has not strayed very far from the position in England.

It is instructive however, before embarking of any study of the Malaysian legislation to discuss general principles in respect of object clauses.

General Object clauses

Traditionally, it had been held that it is insufficient merely to state, rather blanket-like, that the company may *'carry on any business that the company may think profitable'*. Such clauses were struck down as having 'failed' to state the objects.[83]

While the objects of a company are to be stated in the memorandum of association, in practice it has become usual to state specifically what a company's objects are; and thereafter it is possible to include a general-purpose objects clause allowing the company to engage in any business that the members or the directors think desirable. In *HA Stephenson & Son Ltd v Gillanders Arbuthnot & Co,*[84] the company's memorandum of association contained an objects clause, 'To carry on any other business whether manufacturing or otherwise as the company may deem expedient'. The High Court of Australia held that such a clause was valid and could lawfully be an object of the company. Similarly, in *Bell Houses Ltd v City Wall Properties Ltd*[85] the company's memorandum bore the clause, 'To carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to the general business of the company'. This clause was also held to be valid. It is also possible to state or couch objects by way

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83. *Re Crown Bank (1890) 44 Ch D 634, and Stephens v Mysore Reefs [1902] 1 Ch 745*
84. *(1931) 45 CLR 476*
85. *[1966] 2 QB 656*

of very general language: for example in *Re New Finance & Mortgage Co Ltd*[86] one of the objects was stated to be an object to act as 'merchants generally'. Such an object clause has been sufficient to allow a finance company to operate a petrol station and trade as car dealers. Therefore objects clauses which specify certain businesses and conclude with a sweeping- up clause, allowing any business which in the opinion of the directors can advantageously be carried on, do generally satisfy the section.

It is likely, however, that such clauses will be allowed only if some specific object is first stated, since the Act contemplates that a company should state objects in its memorandum of association.

The only question is whether, to be within that object at common law, new businesses adopted under such a clause must have a connection with or natural progression from the specifically authorised existing businesses. The skill of the draftsman has in practice enabled objects clauses to empower a company to carry on a virtually unlimited range of objects, thus, defeating the statutory policy of stating the objects for the benefit of investors and creditors.[87].

However, due to the practical demise of the doctrine of *ultra vires*, the practice of listing a plethora of objects is redundant.

In order to appreciate the full weight of *s 20*, which deals with the doctrine of ultra vires, a perusal of *ss 18* and *19* of the Malaysian *Companies Act 1965*, is necessary, we now turn the local legislation

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86 *[1975] Ch 420*

87 *HA Stephenson & Son Ltd u Gillanders, Arbuthnot & Co (1931) 45 CLR 476; Bell Houses Ltd v City Wall Properties Ltd [1966] 2 QB 656 and Newstead v Frost [1978] 1 WLR 511, [1978] 1 WLR 1441 (CA), [1980] 1 WLR 135 (HL).*

Malaysian Legislation

The law concerning the Memorandum of Association, the charter of the company, is set out at *s 18* of the *Companies Act 1965*. *Section 18* of the *Act* lists out the details that are required to be stated in the Memorandum of Association, which require a statement of its name, its address, the share capital and so on. These do not interest us; for the most important component of a company's memorandum, as constituted in *s 18* is the 'objects clause'. That clause is set out at *subsection (1)(b)* and is in these words:

> **18 Requirements as to memorandum**
>
> (1) The memorandum of every company shall be printed and divided into numbered paragraphs and dated and shall state, in addition to other requirements-
>
> (a) the name of the company;
>
> (b) the objects of the company; ...

However there has been, as had already been seen at Chapter 1, a troublesome tendency in the English courts to either equate or find a distinction between 'objects' and 'powers'. That tendency has not been without its adherents locally, and the concept of powers of a company, and its relationship, if at all, to capacity will be examined next.

Objects, powers, and capacity

Subsection *s 18 (1)(b)* requires that a company must state its objects in its memorandum of association; but as mentioned earlier, the term 'objects' in this context often gets mixed-up with powers as well as objects proper, for as with the

English position, in Malaysian courts there is a tendency sometimes to equate objects (or 'capacity' of a company) with its powers.

In the 1993 Supreme Court case of *Arab Malaysia Finance Bhd v Meridien International Credit Corp Ltd London*[88] is relevant, Jemuri Serjan SCJ said:

> In *s 18, Pt III, Div 1* of our *Companies Act 1965,* the memorandum of association of the company is required to show the name of the company and its objects whereas the powers of the company are covered by *s 19* in *Div 2* of the *Companies Act 1965* thereby showing the distinction between the objects and the powers of the company, but it seems the practice of registering the memorandum of association, which includes both objects and powers together, continues to this day in spite of the strong protest by Lord Wrenbury[89] against such practice.

In order to understand the conceptual distinction it is necessary to refer to the Malaysian statutory position on powers of a company, which are dealt with in s *19* of the *Companies Act*, which states:

> Powers
>
> 19. Powers of a company
>
> 19(1) Subject to subsection (2) the powers of a company, whether incorporated before or after the commencement of this Act, shall include-
>
> (a) power to make donations for patriotic or for charitable purposes;
>
> (b) power to transact any lawful business in aid of Malaysia in the prosecution of any war or hostilities in which Malaysia is engaged; and

88 *[1993] 3 MLJ 193*

89 His Lordship was referring to the House of Lords case of *Cotman v Brougham.*

unless expressly excluded or modified by the memorandum or articles, the powers set forth in the Third Schedule ...

Restriction as to power of certain companies to hold lands ...

While it is not necessary for the present purposes to examine every one of the 26 powers listed in the *Third Schedule* for the sake of convenience, and to assist in the discussion of the cases, some relevant powers are as set out hereunder:

Third Schedule

(Section 19)

POWERS OF A COMPANY

1 To carry on any other business which may seem to the company capable of being conveniently carried on in connection with its business or calculated directly or indirectly to enhance the value of or render profitable any of the company's property or rights.

2 To acquire and undertake the whole or any part of the business, property, and liabilities of any person or company carrying on any business which the company is authorized to carry on, or possessed of property suitable for the purposes of the company.

...5 To take, or otherwise acquire, and hold, shares, debentures, or other securities of any other company.

6 To enter into any arrangements with any Government or authority, supreme, municipal, local, or otherwise, that may seem conducive to the company's objects, or any of them; and to obtain from any such Government or authority any rights, privileges, and concessions which the company may think it desirable to obtain; and to carry out, exercise, and comply with any such arrangements, rights, privileges, and concessions.

...11 To invest and deal with the money of the company not immediately required in such manner as may from time to time be thought fit.

12 To lend and advance money or give credit to any person or company; to guarantee and give guarantees or indemnities for the payment of money or the performance of contracts or obligations by any person or company; to secure or undertake in any way the repayment of moneys lent or advanced to or the liabilities incurred by any person or company; and otherwise to assist any person or company.

13 To borrow or raise or secure the payment of money in such manner as the company may think fit and to secure the same or the repayment or performance of any debt liability contract guarantee or other engagement incurred or to be entered into by the company in any way and in particular by the issue of debentures perpetual or otherwise, charged upon all or any of the company's property (both present and future), including its uncalled capital; and to purchase, redeem, or pay off any such securities.

...

16 To sell or dispose of the undertaking of the company or any part thereof for such consideration as the company may think fit, and in particular for shares, debentures, or securities of any other company having objects altogether or in part similar to those of the company.

...

21 To sell, improve, manage, develop, exchange, lease, dispose of, turn to account, or otherwise deal with all or any part of the property and rights of the company.

22 To issue and allot fully or partly paid shares in the capital of the company in payment or part payment of any movable or immovable property purchased or otherwise acquired by the company or any services rendered to the company.

...

24 To take or hold mortgages, liens, and charges to secure payment of the purchase price, or any unpaid balance of the purchase price, of any part of the company's

property of whatsoever kind sold by the company, or any money due to the company from purchasers and others.

25 To carry out all or any of the objects of the company and do all or any of the above things in any part of the world and either as principal, agent, contractor, or trustee, or otherwise, and by or through trustees or agents or otherwise, and either alone or in conjunction with others.

26 To do all such other things as are incidental or conducive to the attainment of the objects and the exercise of the powers of the company.

On a proper construction of *s 19* and the *Third Schedule*, it would be safe to conclude that the source of power for Malaysian companies to act, omit or do anything arise from four sources, three of which are statutory the final one implied by common law, as follows:

(1) power expressly set out in the memorandum—despite the strictures that only objects may be set forth in it;
(2) powers conferred by *s 19;*
(3) unless expressly excluded or modified by the memorandum or articles, the powers set forth in the *Third Schedule* to the *Act;* and
(4) powers which are implicit in the objects clause; or those that are incidental to the objects of a company, implied by common law.[90]

While by force of use the words 'object' and 'powers' are utilised interchangeably, there is a clear conceptual distinction. As we have seen at Chapter 1, it is said that an 'object' is the purpose for which a company exists, while a 'power' is a legal ability **to do** something. This has prompted some writers to

90 *AG v Great Eastern Rly Co (1880) 5 App Cas 473; Re Horsley & Weight Ltd [1982] Ch 442 at 448.*

conveniently—if not incorrectly— formulate the distinction that 'the 'objects' are the ends while the 'powers' are the means towards those ends'.

This conceptual distinction requires some discussion.

Distinction between powers, object and capacity in Malaysia

For the purposes of clarity, a distinction should be made between 'powers' and 'objects'. In this regard the 1993 Supreme Court case of *Arab Malaysia Finance Bhd v Meridien International Credit Corp Ltd London*[91] is relevant.

The issue in that case, upon an application by the appellants under *Order 33 Rules of the High Court 1980* for the preliminary determination of various points of law, was whether a guarantee issued by the Appellants to the Respondents for the payment of all sums due and owing to a third party-principal debtor known as *Malaysia Air Charter Co Sdn Bhd* was void and unenforceable for being *ultra vires* the objects clause; and/or for contravening the (now repealed) *Finance Companies Act 1969.*

Section 4 of the *Finance Companies Act 1969,* argued the appellant finance company prohibited the issue of such guarantees.

The Supreme Court disagreed; holding that the provision of the guarantee was not the 'primary' object of the company, and had *not* been caught—and hence rendered illegal— by *s 4* of that *Act.*

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91 *[1993] 3 MLJ 193*

What is important in that case is the way the Supreme Court, with a view to prevent the guarantor from escaping from its liability on grounds of illegality, (and in order to bring the provision of the guarantee within the four corners of its objects), interpreted the objects clause of *Arab Malaysia's* memorandum.

Jemuri Serjan CJ (Borneo) at pp. 203-207 discussed the difference between objects in the strict sense as opposed to powers, in the follows words:

> It means that in order to determine the primary objects of the appellant company after the coming into force of the Act, only those of the objects stated in the memorandum of association which conform to the requirements and/or fall within the scope of *s* 2 would be regarded as the primary objects of the appellant company.[92] The other clauses in the memorandum of association which do not conform and/or fall outside the scope of *s* 2 must, of necessity, if they are relevant, be regarded as powers of the appellant company, while others that are not ancillary to the primary objects and fall outside the scope of *s* 2 must necessarily be ignored and regarded as prohibited by virtue of *s* 4. [93]
>
> The distinction, in our view, between the primary objects and the powers of a company, is of importance here as it has a decisive bearing on the determination of this appeal. The memorandum of association should set out the purpose for which the company was formed to achieve and the kind of activities or business which it is to carry on. It is in the object clause of the memorandum of association that the perimeter of permissible activities of the company is set out, so that if it attempts to do anything beyond that perimeter, it is exceeding its objects and thereby acting *ultra vires*. On the other hand, the powers of the company are ancillary to the main objects and are given to the company to enable it to carry on its primary objects or businesses.

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92 Here, Jemuri Serjan SCJ was referring to the proscriptive provisions of the *Finance Companies Act 1969.*

93 *Finance Companies Act 1969.*

His Lordship then quoted Lord Wrenbury, who in the case of *Cotman v Brougham* had remarked on this point at p 522:

> My Lords, I cannot doubt that when the Act says that the memorandum must 'state the objects' the meaning is that it must specify the objects, that it must delimit and identify the objects in such plain and unambiguous manner as that the reader can identify the field of industry within which the corporate activities are to be confined.
>
> The purpose, I apprehend, is twofold. The first is that the intending corporator who contemplates the investment of his capital shall know within what field it is to be put at risk. The second is that any one who shall deal with the company shall know without reasonable doubt whether the contractual relation into which he contemplates entering with the company is one relating to a matter within its corporate objects.
>
> The objects of the company and the powers of the company to be exercised in effecting the objects are different things. Powers are not required to be, and ought not to be, specified in the memorandum. The Act intended that the company, if it be a trading company, should by its memorandum define the trade, not that it should specify the various acts which it should be within the power of the company to do in carrying on the trade'.

To illustrate the difference between the object and the power of a company, Jemuri Serjan SCJ referred to *Re German Date Coffee Co.*[94]

In *Re German Date Coffee Co* , the company was registered for several objects, the first object being to acquire a German patent granted to one Henley for manufacturing from dates a substitute for coffee. The German government declined to grant the patent. The real contemplated object of the company, when it was formed, was to manufacture, in Germany, under a patent that was actually

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94 *(1882) 20 Ch D 169*

granted or about to be granted, coffee from dates. In the contemplation of all parties, the granting of the German patent in Germany was the basis of the company. As that particular was never granted, the entire substratum for the existence of the company was gone. The court allowed the application to wind up the company on that ground.

Lindley LJ, in agreeing with the judgment of the other members of the Court of Appeal, at p 188 made the following observations:

> The first question we have to consider is, 'What is the fair construction of the memorandum of association?' It is required by the Act of 1862 to state what the objects of the company are. In construing this memorandum of association, or any other memorandum of association in which there are general words, care must be taken to construe those general words, so as not to make them a trap for unwary people. General words construed literally may mean anything; but they must be taken in connection with what are shewn by the context to be the dominant or main objects. It will not do under general words to turn a company for manufacturing one thing into a company for importing something else, however general the words are. Taking that as the governing principle, it appears to me plain beyond all reasonable dispute that the real object of this company, which, by the by is called the German Date Coffee Co Ltd was to manufacture a substitute for coffee in Germany under a patent, valid according to German law. It is what the company was formed for, and all the rest is subordinate to that. The words are general, but that is the thing for which the people subscribe their money.

The case of *Stephens v Mysore Reefs (Kangundy) Mining Co Ltd*[95] applied the judgement of Lindley LJ in the German Date Coffee case.

In the *Stephens v Mysore Reefs* case, the company was incorporated as a reconstruction of a former company which had been registered earlier under the name of the Mysore Reefs (Kangundy) Ltd. The first paragraph stated that the

95 *[1902] 1 Ch 745*

company was to acquire and take over as a going concern the undertaking of the Mysore Reefs (Kangundy) Ltd and all or any of the assets and liabilities of that company, and with a view thereto to carry into effect the agreement referred to in *clause* 3 of the articles of association of the company. *Clause* 3 was an agreement for the purchase of the business and assets of the old company from its liquidator. Paragraph 2 contained the power to acquire gold mines, mining and other rights, in Mysore and elsewhere, and to work, exercise, develop and turn to account the same mines, rights and land or interests therein respectively. The company, soon after its incorporation, sent out mining experts to India. The company's mining experts, who had studied the mining property reported that it was undesirable to spend more money upon the property. The directors then attempted to acquire a new property and entered into negotiations with a view to acquiring a property in the British Gold Coast, West Africa. All the shareholders in the company applied for a declaration that a scheme for acquiring, by means of a subsidiary company, an interest in gold mining property in West Africa, proposed by the directors in the circular was *ultra vires* and for an injunction restraining the company from carrying out the scheme.

Swinfen Eady J said the first paragraph of the memorandum had delimited the 'principal or primary object' for which the company was formed. The remaining paragraphs, he said, merely conferred on the company full and ample 'powers' for carrying out that main object. He came to the conclusion that the proposed scheme was not authorized by the memorandum, and therefore allowed the application, following the *dicta* of Lindley LJ in the *German Date Coffee* case.

Serjan SCJ in commenting on the *Stephens v Mysore Reefs* case, observed that reliance on the 'ancillary' powers of the company, particularly paragraph 25, did not rescue the company from being wound up; this was because of the main objects had 'collapsed'.

Referring to Lord Wrenbury's castigation of the practice of registering memoranda, and 'burying beneath a mass of words' the real object of the company, which 'confused power with purpose' in *Cotman's* case[96], Jemuri Serjan SCJ said:

> This is precisely what happened in the memorandum of association of the appellant company which contained 33 paragraphs.
>
> Looking at the memorandum of association of the appellant company, we find that not all the paragraphs set out the primary objects or business of the appellant company so as to come within the scope of s 2 of the Act. Those objects which squarely fall within the definition of borrowing business can easily be identified as paras (1), (4), (5) and (9) and possibly (13).
>
> ... It seems clear to us that all these objects come within the definition of 'borrowing business', i.e. under s 2(a), the acceptance of any money on deposit or loan; s 2(b)(i) the lending, and (ii) the investment of the appellant's funds. The rest of the paragraphs which did not come within the definition of 'borrowing business' must be regarded as the powers of the company in so far as they are ancillary to the carrying on of the primary objects of the appellant company. Paragraph 6, for example, which deals with management of land, buildings and other property that is to be developed by the company under the investment paragraph, is clearly the power given to the company to carry out the investment. Similarly, paras 8 and 17 of the memorandum of association, by their very nature, must be regarded as powers of the company to provide guarantee to persons which have dealings with the appellant company in carrying out its objects.

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96 *[1918] AC 514, at page 523*

> That being the case, therefore, it is our considered view that the provision of guarantees by the appellant company is not the primary object of the company, and by the same token, not its borrowing business. It follows that the issuance of the guarantee was not caught by the prohibition in s 4 of the Act and on the contrary, valid and enforceable against the appellant.

As will be seen later, while the aforesaid discussion would have been unnecessary had the court gone directly to *s 20(1)*, the case itself is important as it is a clear illustration of the purist's argument that the term '*ultra vires*' has been confusingly used to denote other matters which are, strictly speaking, not beyond a company's corporate capacity.

Having discerned this distinction between objects and powers, one now turns to consider the actual legislation in respect of ultra vires, a doctrine which initially appears to have been not enshrined, but entombed in *s 20* of the *Act*, to which we now turn.

Section 20 of the Companies Act 1965

The very section that specifically deals with demise of the doctrine of *ultra vires* is *s 20* of the *Act*. Arguably, what little life that was left in the doctrine was put firmly to rest by s *20* , which states:

> 20 *Ultra vires* transactions
>
> No act or purported act of a company (including the entering into of an agreement by the company and including any act done on behalf of a company by an officer or agent of the company under any purported authority, whether express or implied, of the company) and no conveyance or transfer of property, whether real or personal, to or by a company shall be

invalid by reason only of the fact that the company was without capacity or power to do the act or to execute or take the conveyance or transfer.

(2) Any such lack of capacity or power may be asserted or relied upon only in-

(a) proceedings against the company by any member of the company or, where the company has issued debentures secured by a floating charge over all or any of the company's property, by the holder of any of those debentures or the trustee for the holders of those debentures to restrain the doing of any act or acts or the conveyance or transfer of any property to or by the company;

(b) any proceedings by the company or by any member of the company against the present or former officers of the company; or

any petition by the Minister to wind up the company.

(3) If the unauthorized act conveyance or transfer sought to be restrained in any proceedings under *subsection (2)(a)* is being or is to be performed or made pursuant to any contract to which the company is a party, the Court may, if all the parties to the contract are parties to the proceedings and if the Court deems it to be just and equitable, set aside and restrain the performance of the contract and may allow to the company or to the other parties to the contract (as the case requires) compensation for the loss or damage sustained by either of them which may result from the action of the Court in setting aside and restraining the performance of the contract but anticipated profits to be derived from the performance of the contract shall not be awarded by the Court as a loss or damage sustained.

We will now look at the effects of *s 20*.

The effect of section 20

The effect of *s 20* is three-fold, and is discussed below.

Firstly, neither the company nor a third party outsider may employ the doctrine of *ultra vires* as a defence in order to escape their various duties and or obligations under any impugned transaction.

Secondly, if an outsider does invoke the doctrine of *ultra vires* as a defence, it implies that he had had notice of the fact that the company was acting outside its capacity. If the effect of constructive notice is allowed to remain in Malaysian law, *s 20* would lose its sting; fortunately, *s 20* makes no exception to the existence—or indeed absence—of constructive notice in Malaysian law, and the section applies nevertheless to validate the transaction in question. However, there has emerged a concept as to the knowledge and good faith of third parties, particularly when the court is minded the scrutinise the conduct of outsiders.

Thirdly, there is the situation in which an outsider knows the agent of the company acts for a purpose for which the company has not given authority, the agent has no authority to transact. Now, where the third party outsider knows of this lack of authority, he ought not to be allowed to use that knowledge to challenge validity of the transaction, particularly where the company insists on going ahead with the transaction in question. The issue of notice and agency and its relationship (if at all) to the concept of *ultra vires* is another matter altogether, and is dealt with in *Chapter 4*.

The effect of the *ultra vires* doctrine is much diminished in Malaysia because of *s 20(1)*. The subsection provides that if a transaction is otherwise valid and binding upon a company, the fact that it is *ultra vires* is irrelevant. Lim Beng

Choon J in *Public Bank v Metro Construction Sdn Bhd* [97] had also observed that *s 20(1)* had abolished the otherwise rigorous effect of the *ultra vires* doctrine. In *Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd*,[98] VC George J also felt that section *s 20(1)* had abolished the 'absolute' effect of *ultra vires*.[99] However, this view may not be correct. Having consigned the doctrine to the grave under s 20(1), the law does provide relief to certain class of persons. In fact in the *Bumiputra Merchant Bankers Bhd* case, VC George did observe, at page 449, that *s 20(2)* had ameliorated the effect of *s 20(1):*

> *Section 20(2) of the Companies Act 1965* has the effect of somewhat watering down *s 20(1)*, abolishment of the doctrine of *ultra vires* by providing that lack of capacity or power may be asserted or relied on but only:
>
> (a) in proceedings against the company by any member of the company or by the holder (or the trustees for the holders) of debentures;
>
> (b) in proceedings by the company or by any member of the company against the officers, present or past, of the company; and
>
> (c) in any petition by the minister to wind up the company.

However, the *ultra vires* doctrine does remain peripherally relevant in that any member or debenture holder secured by a floating charge (or trustee for such debenture holders) may sue to restrain the company from doing an *ultra vires* act.

As a general principle any *ultra vires* transaction is no longer a complete nullity as of right. However, the measured and tentative nature of the express words of *s 20(1)* illustrate that the legislature recognises that there are certain areas of company law into which Parliament will not allow *s 20(1)* to interfere. For

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97 *[1991] 1 CLJ 787.*

98 *[1988] 2 CLJ 445*

99 at page 449 of the report

example, issues relating to illegality are not expected to be saved by *s 20(1)*, even where the acts impugned were outside the object clause. In simple terms, *s20(1)* only saves transactions which are *ultra vires* the company. It would not save transactions that fall foul of other areas of the law e.g. breach of fiduciary duties of directors or illegality.

The following passage from the *Sourcebook of Singapore and Malaysian Company Law (1975 Ed) by Philip N Pillai at p 121* lends support to this proposition:

> *Section 20(1)* is in my view directly applicable to the plaintiff's contention that a joint borrowing was beyond the power of Landmark Finance. The plaintiff's allegation is that Landmark Finance lacked the power to give this joint debenture to secure joint borrowings. But even if it did, *s 20(1)* provides in terms that Landmark Finance's act in that connexion shall not be invalid by reason only of the fact that Landmark Finance was without such power. Generally speaking, *sub-s (1)* strikes down the absolute effect of the *ultra vires* doctrine. An *ultra vires* transaction is no longer a complete nullity, incapable of being recognized as a transaction at all. On the contrary, it is a transaction which, in general terms, is not invalid by reason only of the fact that the company was without the capacity or power to enter in the transaction. But whilst the general nullifying effect of the *ultra vires* doctrine is abolished by *s 20(1)*, the legislature has marked out certain fields within which significance will still attach to an excess by a company or its officers of the legitimate scope for its activities as enunciated and restricted by the terms of its objects clause.

The three statutory exceptions to section 20(1)

There are three exceptions to *s 20(1)*, and these are set out at *s 20(2)(a)*, *s 20(2)(b)* and *s20(2)(c)*. Each will be dealt with in turn:

s20(2)(a)

Under *subsection (2)(a)*, a member can restrain a company from doing an act that is 'executory'. Under *s 20(2)(a)* the words 'doing' seems to imply that the 'act' must be one which is being done at the moment the complaint is raised. This privilege extends also to a debenture holder under a floating charge and a trustee for a debenture holder. That the act complained of could have, or has indeed reached its natural conclusion by the time the matter is filed in court, or when it is heard in court seems to curtail much of the effectiveness of this subsection as a remedy.

s20(2)(b)

Under *subsection (2)(b)*, the company may also sue its directors. The suit may be brought against not only present directors, but also former ones. The relief provided by *s 20(2)(b)* expressly overcomes the strictures of the Rule in *Foss v Harbottle*[100] which prohibits a member from suing directors for wrongs committed against the company. This does not serve to invalidate a concluded transaction; it is instead a method of damage control. This exception is a remedy to be resorted to in concert with in an application to restrain the transaction or, if the transaction has already been concluded, may be utilised to obtain compensation for the wrongdoings of the directors.

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100 *(1843) 2 Ha. 461*

s20(2)(c)

Under *s 20(2)(c)*, the Minister of Trade and Industry may wind-up a company which has acted *ultra vires*; but this relief is statutory, and a residual censure in the hands of the Minister.

A question that has not been adequately answered by *s20(2)* is whether a member may rely on an *ultra vires* act or omission to wind-up a company. In two provisions, certain persons are entitled to apply to court to have a company wound-up. The first is under s 181, where, *inter alia* a member is entitled to petition the High Court for relief in cases of oppression; and the other is under *s 218(1) Companies Act 1965*, where a company may be wound-up under certain circumstances, one of which is based upon a complaint, *inter alia* that the directors of the company are conducting the affairs of the company in their own interests rather than in the interests of the members as a whole.

The relevant words of the s 181 are set forth herein:

> 181 Remedy in cases of an oppression
>
> (1) Any member or holder of a debenture of a company or, in the case of a declared company under Part IX, the Minister, may apply to the Court for an order under this section on the ground-
>
> (a) that the affairs of the company are being conducted or the powers of the directors are being exercised in a manner oppressive to one or more of the members or holders of debentures including himself or in disregard of his or their interests as members, shareholders or holders of debentures of the company; or
>
> (b) that some act of the company has been done or is threatened or that some resolution of the members, holders of debentures or any class

has been passed or is proposed which unfairly discriminates against or is otherwise prejudicial to one or more of the members or holders of debentures (including himself).

It is interesting to note that *s181 (1)* confers upon members, (or debenture holders or the Minister) the right to apply to have the company wound up. This power to the Minister seems to be in keeping with *s20 (2)(c)*.

Section 218 is in these words:

218 Circumstances in which company may be wound up by Court

(1) The Court may order the winding up if-

(f) the directors have acted in the affairs of the company in their own interests rather than in the interests of the members as a whole, or in any other manner whatsoever which appears to be unfair or unjust to other members;

(h) when the period, if any, fixed for the duration of the company by the memorandum or articles expires or the event, if any, occurs on the occurrence of which the memorandum or articles provide that the company is to be dissolved;

(i) the Court is of opinion that it is just and equitable that the company be wound up;

(m) the company is being used for unlawful purposes or any purpose prejudicial to or incompatible with peace, welfare, security, public order, good order or morality in Malaysia; or

(n) the company is being used for any purpose prejudicial to national security or public interest.]

Ford seems to think so, for he argues that in a *s 260* Corporations Law application[101] to wind-up a company the applicant may assert a contravention of the company's constitution.[102]

A further exception to s 20(1)

It may be submitted that even regardless whether the transaction has been concluded, it may be set aside on the application of the company or of persons empowered to do so under *s 20(2)(a)* if the third party had actual notice of the fact that the transaction was *ultra vires* the company at the time the transaction was commenced. A fuller discussion of this point will be taken up in *Chapter 4.*

A study of cases: Approach of the Malaysian courts

Having studied the statutory provision, it is now time to examine the approach the courts have taken to the practical application of the doctrine of *ultra vires*, and to observe how the judges have employed the statutory provisions in *s 20*, and to see how far they have been influenced by the common law of England. In order to analyse the rationale behind the courts' decisions, greater attention has been paid to the reasoning of the judges. There will a discussion of five of the following cases:

(1) *Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd [1981] 2 MLJ 58;*

(1) *Pamaron Holdings Sdn Bhd v Ganda Holdings Bhd [1988] 3 MLJ 346;*

(3) *Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd [1988] 2 CLJ 445;*

(4) *Public Bank Berhad v Metro Construction Sdn Bhd [1991] 1 CLJ 787;* and

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101 Which appears to be similar to *s 218(1)(f)* application under the Malaysian *Companies Act 1965*

102 *Ford & Austin, Principles of Corporations Law*, 7th Ed 1995, at paragraph 12.230 at p 494.

(5) *Executive Aids Sdn. Bhd. v Kuala Lumpur Finance Bhd , [1991] 2 CLJ (Rep) 593 [Old Citation [1991] 3 CLJ 1766]*

(1) Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd[103]

In this Singaporean case the plaintiffs claimed for, *inter alia*, $401,793.70 under a written Guarantee of July 31, 1974, by which the defendants had guaranteed payment on demand of all moneys which were then or might thereafter be owing by a third party, one *Ta Leong Produce (Pte.) Ltd.* on the general balance of its account with the plaintiffs. The claim was in respect of four advances made on Letters of Credit. The Guarantee, which was in compliance with clause 97 of the Articles of Association of the Defendant, was executed by two directors of the defendants, Wong Kee Loh and Ong Say Beng. The facts revealed that Wong owned 400,000 shares in *Ta Leong*. To complicate matters, the official address of *Ta Leong* and the defendants was the same.

The defendants contended, *inter alia*, that the Guarantee was signed without their authority.

Of the four questions referred to the High Court of Singapore for determination, the following two are relevant:

(1) had the Guarantee been made *ultra vires*;
(2) Whether Wong have authority to sign the Guarantee.

In so far as the *ultra vires* point went, the learned judge, without adverting to *section 25* of the Singapore *Companies Act (Cap 50)*,[104] made the short observation that:

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103 *[1981] 2 MLJ 58*

> On the question of *ultra vires*, according to the Memorandum and Articles of Association of the defendant company, one of the objects for which the defendants was established under Clause 3(p) was 'to guarantee the obligations and contracts of customers and others'. It is quite obvious from this that the defendant company has express powers to guarantee contracts of its customers.

The learned judge therefore concluded that the transaction was *intra vires* the company due to the existence of clause 3(p) in the company's objects.

However, the learned judge went on to deal with a number of other points traditionally associated with—but conceptually different from—the doctrine of *ultra vires*, e.g. the state of the knowledge of the defendant company, and whether the directors had acted in breach of the articles, or had abused or exceeded their powers. These merit detailed consideration and are set out in *Chapter 4*.

(2) Pamaron Holdings Sdn Bhd v Ganda Holdings Bhd[105]

In this High Court case the plaintiff and the defendant entered into a written agreement for the sale and purchase of shares in a private limited company. The defendant having defaulted in paying the purchase price, the plaintiff applied for summary judgment against it. In resisting the *Order 14* application, the defendant contended, *inter alia*, that the transaction was *ultra vires* the plaintiff company. The learned judge VC George J did not even go into the merits of the argument, and gave short shrift to the defendant's objection. He indicated that as the Defendant was not one of the person contemplated *in s 20(2)*, the doctrine

104 Which is identical in all respects to the Malaysian *s 20(1)*.

105 *[1988] 3 MLJ 346*

availed him nothing. There is nothing else to be garnered from that judgement, save this succinct remark at page 348:

> Another point taken up was that the transaction was *ultra vires* the company. *Section 20* of the *Companies Act* provides that an outsider, other than a debenture holder or the minister, may not raise *ultra vires*. The defendant is an outsider and not a debenture holder or the minister.

There was no other discussion of that point. It appears the VC George J was of the opinion that due to *s 20(1)* and barring the exceptions in *s 20(2)*, the issue of *ultra vires* was a non-event. He reaffirmed this view in the case of *Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd* [106] which is discussed next.

(3) Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd[107]

In this High Court case, the plaintiff bank and the defendant entered into an agreement for the plaintiff to provide bankers' guarantee on behalf of the defendant's clients from time to time. One of the terms of the agreement was that any guarantees issued by the bank in favour of the defendant's customers would be 'counter-guaranteed' by the defendant. By the 'counter-guarantee' the defendant guaranteed the plaintiff payment of the amounts guaranteed by the plaintiff on behalf of the defendant's customer. One such guarantee was issued by the plaintiff on behalf of the defendant's customer, Dirikon, in favour of British American. The defendant in turn issued the plaintiff with a letter of indemnity. Dirikon, in breach of its agreement with British American, failed to

106 *[1988] 2 CLJ 445*

107 *Supra*

repay loan moneys extended by British American, and the plaintiff was called upon to honour its guarantee. The plaintiff paid-up on the British American guarantee and in turn demanded payment from the defendant pursuant to the letter of indemnity issued by the defendant.

After the close of pleading the plaintiff moved the court under *O 33 r 2 of the Rules of the High Court 1980* for certain issues to be tried as preliminary issues. The four issues were:

(1) Whether the defendant had, by virtue *of s 19(1)(c)* of the *Companies Act 1965*, read together with the *Third Schedule* to the Act, power to issue the letter of indemnity in favour of the plaintiff.

(2) Whether the defendant had power under its memorandum of association to issue the letter of indemnity.

(3) Whether, by virtue of *s 20(1)* of the *Companies Act 1965*, the defendant's act in issuing the letter of indemnity is not valid by reason only that the defendant allegedly did not have capacity or power to issue the same.

(4) Whether, by virtue of *s 20(2) of the Companies Act 1965* and in view of the answers to (1), (2) and (3) above, the defendant is barred from asserting or relying on the matters raised in paragraphs 7, 8 and 9 of its defence stating that the letter of indemnity was not in the ordinary business of the defendant.

VC George J (as he then was) began by stating that the first three issues were related to the issue of 'substantive *ultra vires*' dealing with the capacity or power of a company; substantive as opposed to 'procedural *ultra vires*'. This issue will be discussed at *Chapter 4*. Purely on a factual construction and the concession of the defence counsel, it was decided that the first three issues were in favour of the plaintiff.

VC George J said that section *s 20(1)* has abolished the 'absolute' effect of *ultra vires*. He said at page 449 of the report that:

> It is also unarguable that QBE had the capacity and power to secure those guarantees by a charge over their own assets, which QBE did by providing the bank with letters of indemnity in respect of each of the guarantees issued by the bank. A company cannot act *ultra vires* if it does or attempts to do something which falls within the ambit of any one of the objects of the company as set out in the memorandum of association: *Re Horsley & Weight Ltd [1982] 3 All ER 1045; Rolled Steel Products (Holdings) Ltd v British Steel Corp [1985] 3 All ER 52.* In any event, by *s 20(1) of the Companies Act 1965,* no act or purported act of a company shall be invalid by reason only of the fact that the company was without capacity or power to do the act. The section abolishes the absolute effect of the *ultra vires* doctrine. In the premises, the answer to each of the first three questions has to be and is in the affirmative.

That left for adjudication the issues posed by the fourth question which has reference to the effect of *s 20(2)* of the *Companies Act 1965.* The learned judge opined that in fact the second subsection to *s 20* had ameliorated the effect of the first subsection.

In answering the question posed, the judge concluded that proceedings were against QBE brought by the bank, and the facts had not shown that the bank had been a member of QBE or the holder (or trustee for the holders) of any debenture. Therefore the situation had not fallen within any of the exceptions specified in *s 20(2)* of the *Act.* It followed, the learned judge reasoned, correctly as it turned out, that the answer to the fourth question had also to be in the affirmative.

The rest of the judgement substantially dealt with the issue of 'procedural' *ultra vires* which is discussed in *Chapter 4.*

(4) Public Bank Berhad v Metro Construction Sdn Bhd[108]

The defendant company had created two charges over some land belonging to it in favour of the Public Bank, the plaintiff, to secure the repayment of two loans given by the plaintiff bank to a company called *Tenaga Muhibbah Sdn Bhd ('Tenaga').* The charges were duly registered. Following *Tenaga's* default in repayment of the loan, the bank proceeded under the *National Land Code 1965* for an order for sale of the land.

One Lee Khai Hong, who claimed to be a director and the major shareholder of the defendant, resisted the proceedings. In his affidavit-in-opposition, he claimed that two men, one Yeoh Kok Ooi and one Yeoh Seng Lye (the 'two Yeohs'), under the pretext of acquiring the entire share capital of the defendant company, had tricked him and the other directors of the defendant company into resigning from office and had induced them to appoint the two Yeohs as directors in their place. He complained that the two Yeohs had persuaded the outgoing directors to surrender the document of title to the land to them. Without the knowledge of the secretary to the defendant company and its shareholders, the two Yeohs, as directors of the defendant company, had then passed a resolution authorizing the defendant company to create the charges as security for credit facilities granted by the plaintiff bank to *Tenaga.* Lee said that the defendant company had no dealing whatsoever with *Tenaga.* The two Yeohs had apparently failed to pay for the shares which continued to remain with the vendors.

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108 *[1991] 1 CLJ 787*

An order was made for the sale of the land by public auction, but upon the defendant's application, an *ex-parte* order was granted, staying the sale. The bank applied to set aside the order for stay.

At the hearing of the application to set aside the stay order, the defendant contended, in the alternative, that

(1) the execution of the charges was *ultra vires* the defendant company's memorandum of association.

(2) even if the creation of the charges had been *intra vires* the memorandum, it was *ultra vires* the powers of the directors as provided in the defendant's articles of association.

(3) as the charges were created not for the benefit of the defendant company but for the benefit of a third party, the creation of the charges had been outside the borrowing power of the defendant company as provided in the articles.

(4) as the charges were created 'not on account or instruction of the company', the creation of the charges was in breach of the articles.

There was no allegation that the plaintiff bank had knowledge at the material time of the fraud committed by the two Yeohs against the shareholders of the defendant company

The bank contended that:

(a) it had no knowledge whatsoever of the purported frauds committed by the two Yeohs when the third party charges were executed;

(b) the resolution authorizing the creation of the two charges was made available to the bank by Metro when the said charges were executed. The said charges were therefore valid and enforceable by the bank upon default by *Tenaga;*

(c) the bank was not obliged to enquire into the power of Metro to grant third party charges.

The bank also brought to the attention of the court certain factual matters which it said made the defendant's bona fides questionable. Despite the extensive attention focused on the issue relating to *ultra vires*, the following facts appeared to have much exercised the mind of the judge, Lim Beng Choon J, for he makes a special point of reiterating them in the judgement:

(1) upon receipt of this originating summons by Metro's former solicitors, Metro attempted to negotiate with the bank's solicitors for a settlement of the outstanding sum.

(2) As late as 9 February 1987 all the shareholders of Metro, through their former solicitors, had indicated that they were making arrangements to salvage the company and redeem the land and that they would be coming up with some concrete proposals for settlement.

(3) The notice of appointment to hear the originating summons was served on but no one for Metro nor their solicitors appeared at the hearing of the originating summons when the order for sale of the land had been made on 12 February 1988.

(4) Likewise, although Metro had been duly served with the summons no one from Metro had appeared at the hearing of the summons-for-directions made by the SAR.

(5) The bank also produced a letter, written by the solicitors acting for the shareholders of Metro and addressed to the two Yeohs, which indicated, *inter alia*, that unless the two Yeohs took steps to redeem the land and make good the losses sustained by the shareholders, appropriate civil and criminal proceedings would be initiated by the shareholders.

(6) the shareholders were not prepared to accept Yeoh Seng Lye's offer to resign as director of Metro made on 8 August 1985.

(7) By reason of the conduct of six shareholders of Metro it was alleged that they had not acted bona fide in their application to set aside the order for sale.

It will be useful to remember these facts, for their very presence in the judgement tells us how the judicial mind, in recognising that certain facts, which, while not bearing any relevance to the central issues posed for the determination of the court, took away much of the conviction in the defendant's own arguments, and which facts, ultimately, appeared to have swayed the mind of the judge.

Counsel for Metro posed two questions to the court:

(Q1). Whether the third party charges were *ultra vires* the company's memorandum of association ('substantive' *ultra vires*)—and if so whether the transactions were saved by *s20(1)* of the Act.

(Q2). Whether the third party charges even if *intra vires* the company's memorandum, if created by the directors acting outside and beyond their powers as provided in the company's articles of association ('procedural

ultra vires') binds the company and whether *s 20* of the *Companies Act 1965* applies to such circumstances.

The memorandum of Metro stated that the company was established to carry on a very wide range of business enterprises such as housing development, importing, exporting, manufacturing and sales of many kinds of goods, running of hotels and restaurants, operating travel agencies, mining and quarries. One significant object was set out in *sub-cl.(31) of cl.3* and read as follows:

> To carry on business as financiers, factors, moneylenders, hire-purchase financiers, concessionaires, manufacturers representatives, forwarding and collecting agents, insurance agents, real property and estate brokers and agents, commission, managing and general agents, indenting agents, franchise holders and dealers in options of all kinds and to promote, undertake, execute, operate, transact, supervise or otherwise carry on all kinds of financial, trading, manufacturing, processing, milling, curing, packing and maintenance servicing business or other kinds of business which may be capable of being carried on in connection therewith.

The company had also incorporated certain powers to carry out the aforesaid objects, and these were as follows, and can be found at page 791 of the judgement:

> (40) To invest, lend, advance or otherwise deal with the company's moneys not immediately required in such a manner as shall from time to time be determined and to draw, accept, endorse, discount, issue or otherwise execute debentures, mortgages, bills of lading or exchange, promissory notes, guarantees and other negotiable or transferable instruments.
>
> (41) To lend and advance money on any term as may be determined to customers, agents, dealers or employees of the company or other corporations or persons who have

dealings with the company and to guarantee the payment of any loan made to any of them.

(44) To borrow, raise or otherwise secure the payment of money or loans by mortgage, guarantee, issue of debentures or in other manner which may be beneficial to the company and for the purposes or for any lawful purpose to charge all or any of the properties, assets or uncalled capital, present and future, and collaterally or further to secure any securities of the company by a trust deed or other assurance.

(50) To guarantee or become liable to or give securities for any payment of money, repayment of loans or any credit facility, performance of contracts or duties or any issue of letters of guarantee, hypothecation or credit by any bank, company, person or others on account or instruction of the company.

It is also necessary, before going any further, to peruse the relevant articles which were considered by the court. The articles in question were in these terms:

4 Any branch or kind of business which by the memorandum of association of the company or by these articles is either expressly or by implication authorised to be undertaken by the company, may be undertaken by the directors at such time or times as they shall think it fit and further may be suffered by them to be in abeyance, whether such a branch or kind of business may have been actually commenced or not, so long as the directors may deem it expedient not to commence or proceed with such a branch or kind of business.

86 Unless otherwise determined by a general meeting, the number of directors shall not be less than two nor more than seven.

98 The directors may entrust to and confer upon the managing director, joint managing directors and assistant managing directors any of the powers exercisable by them as directors on such terms and conditions and with such restrictions as they think fit and either collaterally with or to the exclusion of their own powers and may from

time to time revoke, withdraw, alter or vary all or any of the powers entrusted or conferred.

102 The business of the company shall be managed by the directors, who may pay all expenses of and preliminary and incidental to promotion, formation, establishment and registration of the company as they think fit, and may exercise all such powers of the company and do on behalf of the company all such acts as may be exercised and done by the company except such powers or acts which by the Act or by these articles are required to be exercised or done by the company in general meeting, subject nevertheless to the provisions of these articles, to the provisions of the Act and to such regulations being not inconsistent with the aforesaid regulations or provisions as may be prescribed by the company in general meeting, but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if such regulations had not been made.

103 The directors shall have power to borrow or raise money from time to time for the purpose of the company or secure the payment of such a sum as they think fit and may secure the repayment or payment of such sums by mortgage or charge upon all or any of the properties or assets of the company or by the issue of debentures (whether at par or at discount or premium) or otherwise as they may think fit. *(court's emphasis).*

119 The quorum necessary for the transactions of the business may be fixed by the directors and unless so fixed at any other number, shall be two. A meeting of the directors at which a quorum is present shall be competent to exercise all the powers and discretions for the time exercisable by the directors.

124 A resolution in writing signed by all the directors shall be as valid and effectual for all purposes as a resolution passed at a meeting of the directors duly convened, held and constituted.

> The seal shall not be affixed to any instrument except by the authority of a resolution of the board of directors and in the presence of any two directors or of at least one director and of the secretary or such other person as the directors may appoint aforesaid shall sign every instrument to which the seal is so affixed in their presence and in favour of any person bona fide dealing with the company. Such signatures shall be conclusive evidence of the fact that the seal has been properly affixed.

Effect of inclusion of powers in the memorandum

Before answering the questions posed, Lim Beng Choon J considered whether or not the inclusion of powers into the objects clause tended to render it inconclusive. He observed, at page 791, that although a company's memorandum ought only to set out its objects, the undesirable practice of including powers into the memorandum, while to be deprecated, did not render the memorandum inconclusive.

The learned judge then considered the first question posed to him, i.e. whether the third party charges were *ultra vires* the company's memorandum of association (substantive *ultra vires*).

He reiterated the English common law position as to *ultra vires*, and discussed various subsidiary principles of law associated with the English common law doctrine of *ultra vires*; e.g. the mode of construction of object clauses, their later validation by a general meeting, and the rationale therefor. For instance, he noted that the company could not, whether by way of a consent order, or by way of the consent of its members in a general meeting, validate an act which was in fact in excess of its objects. Neither did the equitable principle of estoppel rescue the act impugned.

Construction of objects clauses

The learned judge then addressed the issue of how the objects clauses in a memorandum ought to be construed, in these words, at page 793 also:[109]

> Next it must be borne in mind that in the construction of the object clauses of a memorandum, the ordinary rules applicable to the construing of documents apply equally well to the construction of the object clauses. There is no special rule of interpretation by reference to what are supposed to be the main or principal objects of a company where the question is whether something done or proposed to be done is *ultra vires*.

In reciting the common law in this way, Lim Beng Choon J adopted the judicial view of the doctrine of *ultra vires* as a principle developed to protect third party outsiders. Lord Parker in *Cotman v Brougham* had discerned the dual role of the need to state a company's objects in its memorandum.

Lord Parker had said at p520-521 that:

> The question whether or not a transaction is *ultra vires* is a question of law between the company and a third party. The truth is that the statement of a company's objects in its memorandum is intended to serve a double purpose. In the first place it gives protection to **subscribers**, who learn from it the purposes to which their money can be applied. In the second place it gives protection to **persons who deal with the company**, and who can infer from it the extent of the company's powers. The narrower the objects expressed in the memorandum the less is the subscribers' risk, but the wider such objects the greater is the security of those who transact business with the company. Moreover, experience soon showed that persons who transact business with companies do not like having to depend on

[109] Following the *dicta* of *Lord Parker said at pp. 520-521* in *Cotman v Brougham [1918] AC 514*,; this was followed by Salmond J in *Anglo Overseas Agencies Ltd v Green & Anor [1960] 3 All ER 244.*

> inference when the validity of a proposed transaction is in question. Even a power to borrow money could not always be safely inferred, much less such a power as that of underwriting shares in another company. Thus arose the practice of specifying powers as objects, a practice rendered possible by the fact that there is no statutory limit on the number of objects which may be read as ancillary to and exercisable only for the purpose of attaining what might be held to be the company's main or paramount object, and on this construction no one could be quite certain whether the court would not hold any proposed transaction to be *ultra vires*. At any rate, all the surrounding circumstances would require investigation. Fresh clauses were framed to meet this difficulty, and the result is the modern memorandum of association with its multifarious list of objects and powers specified as objects and its clauses designed to prevent any specified object being read as ancillary to some other object.

The first, as Lord Parker opined *Cotman v Brougham*, was to protect a company's 'subscribers', who, Lord Parker said, could learn from the memorandum the purposes to which their money could be applied. This phrase is unusual in that Lord Parker did not seem to have stopped to reflect that his explanation for the rationale of the first purpose, as he had apprehended, (i.e. to protect the 'subscribers'). By definition he had encompassed a company's subscriber as a 'third party'. It is clear from the express words of the Malaysian *s 20(2)* that one of the classes of person to whom it gives relief—albeit in a limited sense—is to a shareholder, who would be an 'insider'. By the phrase 'subscribers' above, Lord Parker must have meant persons who desire, sometime in the near future, to invest in the company but who have not yet become shareholders. The second rationale advanced by Lord Parker, was that the doctrine was to protect persons who 'dealt with' the company, and who could infer from it the extent of the company's powers. The second rationale, admittedly, encompasses a clearer definition of a 'third-party outsider'.

Burden of Proof in proving good faith of third party

Lim Beng Choon J then observed that in common law, a third party is not required to inquire into the capacity or any limitation of its directors' powers. This appears to bring into play the principle in *Turquand's* case, although the learned judge made no reference to that case; this is discussed in *Chapter 4.* The judge said that the burden of proof, in proving that the third party did not act in good faith, fell upon the person asserting it.

Where it came to the central issue in question, i.e. the borrowing of money, the learned judge adopted the *dicta* in *Re David Payne & Co Ltd [1904] 2 Ch 608* and followed by Harman LJ in *Re Introduction's Ltd [1969] 1 All ER 887 at p 890,* that where a company has a general power to borrow money for the purposes of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied, and the misapplication of the money by the company does not avoid the loan in the absence of the knowledge on the part of the lender that the money was intended to be misapplied.

Nevertheless the learned judge, made a finding of fact that *clause 3(31)* of the objects was in fact sufficiently wide to enable Metro to carry on business akin to that of a financial institution. At page 794, he concluded that:

> Reverting to the object clauses of the memorandum of association of Metro, I have no doubt that the object under cl 3 sub-cl (31) is wide enough to indicate that one of the objects of Metro is to carry on the business akin to that of a financial institution which, needless to say, includes that of raising money from loan by way of a charge on real properties.

There is a notable difficulty in this particular finding of fact. If the learned judge is right, the defendant could have, indeed was bound to have succeeded, on the

grounds of illegality, had he pleaded a breach of *section 4* (read together with *s 2*) of the *Finance Companies Act 1969*. To explain this difficulty one has to turn to the Supreme Court case of *Arab Malaysian Finance Berhad v Meridien Credit Corporation Ltd London [1993] 3 MLJ 193*, a matter that is discussed at *Chapter 4*.

Unauthorised acts of directors

One of the arguments was that as the charges had been created *not 'on account or instruction of the company'*, and that the creation was in breach of sub-cl 50 (i.e. that *'To guarantee or become liable to or give securities etc ... on account or instruction of the company'*).

The judge rejected that contention, and concluded that at the time the charges were executed (13 December 1984) the bank had had no knowledge of the alleged fraud committed by the two rogue directors. The judge reasoned that the fraud committed by the two directors against the shareholders and the excess of authority on the part of the said directors was a matter only between the said directors and the shareholders. The only way the transaction would have been vitiated, suggested Lim J, relying on the authority of *The Royal British Bank v Turquand 119 ER 474*, was if illegality could have been proven. This is discussed at length at *Chapter 4*.

Transactions not for the benefit the company but which benefit third parties

The second argument advanced by the company was that the two impugned charges were created 'not for the benefit of the company' but for the benefit of a third party, and that their creation was therefore outside the borrowing power of the company (conferred under sub-cl 44, i.e. 'To borrow, raise or otherwise

secure the payment of money or loans by mortgage, guarantee, etc ...which may be beneficial to the company and for the purposes or for any lawful purpose ....'). This is discussed at *Chapter 4*.

Despite the foregoing discussion, Lim J opined that had the third party charges been *ultra vires* the company's memorandum and articles of association, the transactions in questions were saved by *s 20(1)* of the *Companies Act 1965*. The leaned judge stated that *s 20(1)* had abolished the otherwise rigorous effect of the *ultra vires* doctrine. As has been observed earlier, this view may not be wholly correct or wholly wrong.

(5) Executive Aids Sdn. Bhd. v Kuala Lumpur Finance Bhd[110]

In this High Court case, again presided over by Lim Beng Choon J, the plaintiff company, were the owners of a piece of land. They had charged the land to the defendant as security for the repayment of a loan granted by the defendant to a third party company called *Radio & General Trading Co (Holdings) Sdn Bhd ('R & G')*. The defendant had obtained an order for sale of the land by public auction from the Land Administrator following an application for sale made under the provisions of the *National Land Code 1965* following default in repayment of the loan.

By this action, the plaintiff sought, *inter alia*, a declaration that the charge was void and/or unenforceable against the plaintiff and that therefore the order for sale was null and void and also an order that any auction pursuant thereto be set aside.

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110 *[1991] 2 CLJ (Rep) 593 [Old Citation [1991] 3 CLJ 1766]*

The detailed facts however, need a little attention, as they will be relevant, later on, to the issue of knowledge and authority. In developing Kuala Lumpur Plaza ('KL Plaza') Lian Seng Properties Sdn Bhd ('LSP') had contracted with *R & G* to carry out the mechanical and electrical installation works on KL Plaza. Substantial works on the project had been carried out by *R & G*. By January 1986 LSP was indebted to *R & G* for a sum in excess of RM1 Million in respect of the works done by *R & G*. Arthur Chan, who was at the material time a director of the Plaintiff, was also at the material time a director of *R & G*.

Due to the substantial sum owing by LSP to *R & G* for which LSP had failed to pay despite repeated demands, Arthur Chan, as director of *R & G*, went to see Wong Teck Lim ('Wong'). Wong who was at the material time a director of LSP as well as a director of the defendant company. At the meeting, as an interim measure, one Tan Chor Eng, a shareholder of the plaintiff, with the concurrence of Wong suggested that *R & G* should obtain a loan of RM0.5M ('the loan') from the defendant so that *R & G* would have sufficient liquid funds to meet its pressing expenses incurred in carrying out the works on KL Plaza at LSP's requests for which LSP had then yet to pay *R & G*.

Apparently Arthur Chan agreed to the proposal and Wong Teck Lim later arranged with the defendant to lend RM0.5m to *R & G*. Since the defendant could not lend money without security, it was suggested that the land held by the plaintiff was to be charged to the defendant. As a result, by way of a letter dated 5th February 1986, the defendant forwarded a letter of offer to the plaintiff and offered to grant a term loan of $0.5m to the plaintiff payable within six months. As security for the loan the Plaintiff's land was to be charged to the defendant. There were other conditions set out in the said letter. For the purpose of this discussion three of the conditions are worthy of note, which were:

(a) Receipt of the board resolution from the borrower authorizing the borrowing and acceptance of the facility.

(e) All relevant loan and security documents shall have been executed by the borrowers and presented for registration at the appropriate authorities.

(f) Receipt of a true copy of memorandum and article of association of borrower.

R & G accepted the offer. Thereafter the charge was duly created by the plaintiff over the land in favour of the defendant.

It was alleged by the plaintiff that at all material times *R & G* and the plaintiff were not related to each other in any manner whatsoever except that there were some common shareholders/directors. It was also alleged that the defendant knew that the plaintiff and *R & G* (being the borrower of the defendant) were not related, nevertheless requested the charge to be created. The plaintiff therefore contended that the charge was void and unenforceable because:

(1) the charge was *ultra vires* the powers of the plaintiff and/or was not for the benefit or purpose of the plaintiff; and/or

(2) the defendant had knowledge (through their director Wong) or had, in any event 'constructive notice' of the non-relationship as between *R & G* and the plaintiff; and

(3) the purpose for which the loan was intended was to reduce the pressure on LSP to pay to *R & G* the debt due and owing by LSP to *R & G*.

Nevertheless following the commencement of the proceedings before the Land Administrator, the plaintiff had negotiated with the defendant to settle the loan and did not raise the question of the validity of the charge before the Land Administrator. A number of times, the plaintiff had requested the Land

Administrator to postpone the sale that he had ordered before the plaintiff finally brought the question of the validity of the charge to the court, a delay of two years.

It was not disputed that a director of the defendant was also a director of the developer for whom *R & G* was working. It was contended that this common director had knowledge of the fact that the loan was not for the benefit of the plaintiff and that such knowledge must be imputed to the defendant as well.

Simply put, the court had doubts about the *bona fides* of the plaintiff's application in view of its conduct prior to—and in the course of—the action. The court dismissed the action holding that any defects in the procedure adopted by the chargee in his application for an order for sale which must include defects in the charge itself should be raised at the enquiry held by the Land Administrator. The chargee or the chargor could not be allowed, the court felt, to reopen the enquiry by bringing in a matter which the party concerned had failed to bring in at the beginning. If the plaintiff had any right to challenge the order of the Land Administrator, they should have appealed to the High Court under *s 41* read with *s 31* of the *Code*.

Nevertheless the court took great pains to deal with the *ultra vires* point, and to this discussion we must now revert:

The questions posed by the plaintiff were, in respect of the *ultra vires* issue were whether:

(1) the charge was *ultra vires* the powers of the plaintiff and/or was not for the benefit or purpose of the plaintiff; and/or;

(2) the defendant had knowledge (through their director Wong) or had, in any event 'constructive notice' of the non-relationship as between *R & G* and the plaintiff; and

(3) the purpose for which the loan was intended was to reduce the pressure on LSP to pay to *R & G* the debt due and owing by LSP to *R & G*.

However, the real issue before the court were, in fact:

(1) whether the third party charge of the defendant's property was *ultra vires* the objects of the plaintiff company as set out in its memorandum of association, and if so, whether the transaction is saved by *s 20(1)* of the *Companies* Act 1965;

(2) whether the third party charge even if *intra vires* the plaintiff company's memorandum, if it had been created by the directors acting outside and beyond their powers in that the charge was not created for the benefit or interest of the plaintiff company can be regarded as validly created, and if not, whether s 20(1) of the Companies Act 1965 applies to validate the charge.

In order to answer these two questions, it is necessary to examine the relevant clauses of the memorandum of association of the plaintiff company. Clause 3 of the memorandum indicated that the plaintiff company was established to carry on a very wide range of business enterprises such as housing development, importing, exporting, manufacturing and sale of many kinds of goods, operating of hotels and lodging facilities, operating of travel agencies, mining, quarry and so on.

Four significant objects of the plaintiff were set out in paras 31, 32, 33 and 56 of the said cl 3 as follows:

(31) To transact business as financiers, promoters and financial and monetary agents in any part of the world and for such purposes to establish agencies and to appoint financial and managing agents and attorneys and to produce the company to be registered and recognized.

(32) To receive money on deposit **or to borrow or raise money with or without security**, or to secure the payment or repayment of money or the satisfaction, observance or performance of any obligation or liability undertaken or incurred by the company **in such manner as the company thinks fit** and in particular by mortgage or charge upon the undertaking or any part of the undertaking of the company or upon all or any assets of the company or by the creation and issue of debentures or debenture stock (perpetual or terminable) charged as aforesaid or constituting or supported by a floating charge upon present and future property including uncalled and called but unpaid capital.

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

(56) To make contributions and donations and in any other manner to give aid and assistance and help to any person, firm company, association, society or other body or party for any whatsoever object or purpose.

Clause 3 of the memorandum then had a general statement, as follows:

... further that the objects specified in each paragraph of this clause shall be regarded as independent objects and accordingly shall except where otherwise expressed in any paragraph be **in nowise limited or restricted by reference to or inference from the terms of**

any other paragraph or the name of the company but may be carried out in as full and ample a manner and construed just as wide a sense as if the paragraph defined the objects of a separate distinct and independent company.

Upon reading of the memorandum the court entertained no doubt that the plaintiff was in fact empowered to create a third party charge on the property to secure a loan for *R & G*.

But the contention was that the charge had not been created 'for the benefit or for the furtherance of the objects' of the plaintiff company; and hence the charge was null and void. Lim J referred to His Lordship's previous decision in covering the identical point in his judgment in *Public Bank Bhd v Metro Construction Sdn Bhd*[111] in which His Lordship had distilled the principle of law covering that very point i.e. where a company has a general power to borrow money for the purposes of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied and the misapplication of the money by the company does not avoid the loan in the absence of knowledge on the part of the lender that the money was intended to be misapplied, relying on *Re David Payne & Co*[112] which had been cited with approval by Harman LJ in *Re Introduction Ltd.*[113]

The learned judge then reviewed *Rolled Steel Products (Holdings) Ltd v British Steel Corp & Ors*[114] quoting Browne-Wilkinson LJ, who had explained[115] that there was a critical distinction between acts done in excess of the capacity of the company on the one hand and acts done in excess or abuse of the powers of the company on the other. Had the transaction been beyond the capacity of the

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111 *Supra*
112 *[1902] 2 Ch 608*
113 *[1969] 1 All ER 887 at 890*
114 *Supra*
115 at p 92 of the relevant judgement

company it is in any event a nullity and wholly void; whether or not the third party had notice of the invalidity, property transferred or money paid under such a transaction will be recoverable from the third party.

If, on the other hand, the transaction (although in excess or abuse of powers) is within the capacity of the company, the position of the third party depends on whether or not he had notice that the transaction was in excess or abuse of the powers of the company. As between the shareholders and the directors, for the most purposes it makes no practical difference whether the transaction is beyond the capacity of the company or merely in excess or abuse of its powers: in either event the shareholders will be able to restrain the carrying out of the transaction or hold liable those who have carried it out.

Applying these principle, as the creation of a third party charge as security for a loan to *R & G* was held to be within the ambit of the object clause of the memorandum of the plaintiff. The defendant, therefore had no business to enquire as to whether the plaintiff has misapplied the loan.

An important point to note in the *Executive Aids* case is that at page 97 the learned judge made this observation:

> Furthermore the defendant was, insofar as the object clause was concerned, not put on notice by any express requirement that the power to take a loan is only exercisable for the purposes of the company's business.

Conclusion

It can be seen therefore '*ultra vires*' has been confusingly used to denote other matters which are, strictly speaking, not beyond a company's corporate capacity.

An act that is beyond the company's capacity (*ultra vires* in the strict sense) should be distinguished from an act that is a breach of the company's articles or an abuse of the director's powers.

Acts that are in breach of the company's articles or which amount to an abuse of a director's powers have nothing to do with the company's capacity as such. These acts may be restrained, but on different principles. Taking the argument a little further, an act that is beyond the powers of an agent is not necessarily *ultra vires*. Agency and capacity are distinct principles, despite the fact that the courts have had to endure a running in of both principles; and this will be discussed at *Chapter 4* .

Finally, *ultra vires* ought not be confused with illegality. An act that is illegal (in the sense of being contrary to law or public policy) is void on general principle, and this is discussed at *Chapter 4.*

As is the English position, and very much in tandem therewith, in Malaysia, where a company acts outside of its objects, that act is said to be '*ultra vires*' or beyond the legal powers of the company. In such a situation, the doctrine of *ultra vires,* on a plain application of that principle – and for the moment to the exclusion of *s 20(1)* – applies only to a breach of the memorandum; and not of the Articles of Association. A breach of articles give rise to a different set of consequences; and we are not concerned with these at the moment.

Therefore, on a proper reading of the authorities, if one was a lending institution, or in any event a third party, and if it transpired that the third party had express notice of the existence of a clause in the memorandum that the power to take a loan from the third party was to be only exercised for the purpose of the business of the company; the third party lender was not, in law, put on notice, nor had constructive notice, nor put on inquiry so as to require the third party lender to satisfy itself that the loan was in fact being taken for the purposes of the advancement of the company or in compliance with or for the furtherance of the objects of the company.

CHAPTER 4

THE RELATIONSHIP OF *ULTRA VIRES* TO OTHER CONCEPTS

There are a collection of common law rules designed to facilitate certainty and efficacy in commerce, whether the rule in *Turquand's* case, or the body of rules as to authority of a company's officers, of the rules as to knowledge. The courts have, particularly in the cases that we saw in Chapter 3, force-fitted these concepts, as if they were part and parcel of the body of law relating to the *ultra vires* doctrine. This is not only conceptually erroneous but also reanimates the almost dead doctrine. We shall see in this chapter how courts have struggled with the issue of internal breaches of procedure by intermingling common law principles with issues involving the capacity of a company.

This chapter will discuss the influences of this intermingling of common law with statute, particularly in light of *s 20 Companies Act 1965*.

A major of areas discussed here are Authority and Agency, illegality, and knowledge of third parties. Unfortunately because the courts have bound up these principles in different combinations it is difficult to compartmentalise them under different heads with any amount of clarity. Perhaps the confusion that results is not external, but an outward reflection of the inherent confusion of the law in this area.

Before a discussion is embarked upon these three major issues, reference ought to be made to the problem of the loose terminology used to distinguish between excesses of capacity as compared to internal breaches of the constitution of the company. Various phrases were used to describe them; latterly 'substantive ultra vires', and 'procedural ultra vires' have been in vogue. In England the labels used in describing the dichotomy of these concepts were 'ultra vires in the narrow sense' (i.e. issues relating only to capacity of a company) and ultra vires in the 'wide sense' (i.e. issues relating generally to internal breaches of the constitution of the company).

We turn now to the preliminary issue.

'Substantive' and 'Procedural' *ultra vires*

In a number of local cases the judges have made reference to two different kinds of *ultra vires*, preferring to distinguish them by the phrases, 'substantive' or 'procedural' *ultra vires*. These cases will now be examined:

VC George J in *Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd*[116] also refers to this when he says, at page 448 of the judgement:

> The first three questions or issues, the subject of this preliminary trial, clearly deal with what has been described as substantive (as opposed to procedural) *ultra vires*. The first three questions in effect deal with the question whether QBE by its memorandum of association or by the provisions of the Third Schedule to the Companies *Act* 1965 had the capacity or power to enter into the Dirikon transaction

[116] [1988] 2 CLJ 445

whereby QBE provided the bank with the letter of indemnity in respect of the bank guaranteeing the repayment by Dirikon of the loan to it by British American.

The defendant had contended that the transaction, by which the company had provided, on behalf of a third party ('Dirikon') a guarantee to the bank, had amounted to what counsel described as 'procedural *ultra vires*'.

The relevant portions of *Article 59* of QBE was in these terms:

> 59(b) The company and the directors shall not be entitled to enter into complete or effect any of the following transactions or things unless a resolution passed by a special majority (as hereinafter defined) of the members of the company at a general meeting has first been obtained:
>
> any contract outside the ordinary course of business;
>
> ....
>
> ....
>
> (vi) the making or receiving of loans or the giving of guarantees or security;
>
> (a) other than in the ordinary course of business;
>
> (b) in favour of any shareholder of the company or to a company in which such shareholder holds or is beneficially entitled to 15% of its issued share capital, or voting power.

The argument was that the transaction involving Dirikon was one outside the 'ordinary course of business' of QBE and as such pursuant to *art 59(b)* of the memorandum of association could not have been embarked upon without a resolution of the company in a general meeting. Counsel for the bank conceded that the bank had notice, at the material time, of the terms of the article in question. He also conceded that the bank had been aware that there was, at the

material time, no resolution passed in accordance with *art 59(b)* of QBE. Defence counsel referred to this perceived error as 'procedural *ultra vires*'.

The issue was whether this breach of procedure or 'procedural *ultra vires*' had rendered invalid, if not unenforceable, the guarantee granted by QBE.

The issue posed raised a two-step approach to the point of contention. The first step was to determine whether the bank had the burden of proving that the correct procedure had been complied with, or whether the defendant had the burden of proving that in fact there had been a breach of procedure. The second step was to determine what—assuming the burden had been discharged, on whomsoever the burden fell — was the effect of the breach. That is not what the judge chose to do, however, for having taken the first step, the learned judge side-stepped the second, as we shall shortly see.

Step-1: Burden of Proof

The learned judge decided that he who asserts ought to bear the burden of proof. For this purpose it mattered not whether the issue was posed at trial or one posed during the arguments of the preliminary points raised under the Order 33 application. The learned judge said at page 450:

> I pause to deal with the contention by Encik Sri Ram that the burden of proving that the Dirikon transaction was within the ordinary course of business of QBE was on the bank. Paragraphs 7 and 8 of the statement of defence show that the assertion that the transaction was not in the ordinary course of business of QBE is made by the defendant QBE and relying on that, QBE contends that the transaction is void *ab initio*. In my judgment, in the circumstances, the burden of proving that the transaction was not in the ordinary course of

business of QBE falls on QBE in that it is trite that he who asserts must prove. There was a suggestion that because these issues are being tried as preliminary issues, the burden which otherwise would fall on the defendant shifts to the plaintiff. I am afraid that I have failed to see the logic for or any merit in the suggestion.

Step-2: Consequences of breach of internal mechanisms

The learned judge then examined the objects of the company, and continued at pages 450-451 in these words:

> The objects for which QBE was established have been examined. It seems to me beyond any doubt that the Dirikon transaction (as do the other 13 transactions) fall squarely within the terms of one or more of cl 3(1), (4) and (19) of the memorandum of association. It seems to me in the absence of evidence to the contrary, the plaintiffs are entitled to ask the court to hold that those objects for which the company was established set out the ordinary course of business of the defendants. The burden of proving that they are not, I have already held, is on the defendant and the defendant has not even sought to prove that the Dirikon transaction was outside the ordinary course of the business of QBE. On the totality of the evidence before me, I hold that the business of insurance against contingencies of all descriptions or by way of guarantee is in the ordinary course of business of QBE; I also hold that the carrying on of every kind of insurance business connected with, *inter alia*, guarantee insurance is part of the ordinary business of QBE; I further hold that guaranteeing the contracts of any person or company is part of the ordinary business of QBE and the securing of such guarantees by a charge over any or all of the assets of QBE is part of the ordinary business of QBE.

Having thus concluded, a little unfortunately for this discussion, the learned judge completely side-stepped the second step, and decided the question in favour of the Plaintiff, in these words, at page 451:

> Accordingly, I hold that the Dirikon transaction was part of the ordinary business of QBE and, accordingly, art 59 has no relevance in respect thereof. There was no need for a resolution of the company in a general meeting and, accordingly, there was no procedural *ultra vires* as suggested by learned counsel for the defendants or at all.

This therefore compels us to examine what other cases have said in respect of the same.

Transactions in breach of the articles of association

However, what if the defendant had managed to prove that in fact the entire transaction was in breach of the articles? The result will depend on the knowledge of the bank.

This was the decision reached by Lim Beng Choon J in *Executive Aids Sdn Bhd v Kuala Lumpur Finance Berhad*. The contention in that case was that the charge over a piece of land, belonging to the company, for the benefit of a third party, had not been created 'for the benefit or for the furtherance of the objects' of the plaintiff company; and hence the charge was null and void.

Lim J referred to his previous decision covering an identical point in his judgement in *Public Bank Bhd v Metro Construction Sdn Bhd*[117] in which His Lordship had held that where a company has a general power to borrow money

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117 *Supra*

for the purposes of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied and the misapplication of the money by the company does not avoid the loan **in the absence of knowledge on the part of the lender that the money was intended to be misapplied**, relying on *Re David Payne & Co.*[118]

In *Rolled Steel Products (Holdings) Ltd v British Steel Corp & Ors*[119] Browne-Wilkinson LJ, had explained the principle at p 92, in these words:

> The critical distinction is, therefore, **between acts done in excess of the capacity of the company** on the one hand **and acts done in excess or abuse of the powers of the company on the other.** If the transaction is beyond the capacity of the company it is in any event a nullity and wholly void; whether or not the third party had notice of the invalidity, property transferred or money paid under such a transaction will be recoverable from the third party. **If, on the other hand, the transaction (although in excess or abuse of powers) is within the capacity of the company, the position of the third party depends on whether or not he had notice that the transaction was in excess or abuse of the powers of the company.** As between the shareholders and the directors, for most purposes it makes no practical difference whether the transaction is beyond the capacity of the company or merely in excess or abuse of its powers: in either event the shareholders will be able to restrain the carrying out of the transaction or hold liable those who have carried it out.

Having explained the case of *Re David Payne & Co Ltd*, Browne-Wilkinson LJ in *Rolled Steel* went on to make the following proposition, at p 93:

> That case, therefore, is clear authority for two propositions: (1) that where there is power to borrow for the purposes of the company's business (even if contained in the objects clause)

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118 *[1902] 2 Ch 608.* That case had been cited with approval by Harman LJ in *Re Introduction Ltd. [1969] 1 All ER 887 at 890*

119 *Supra*

and the borrowing is made otherwise than for those purposes, the borrowing is not void as being *ultra vires*; and (2) a third party is not put on notice by an express requirement that the power is only exercisable for the purposes of the company's business.

Thus, Lim J observed that the creation of a third party charge as security for a loan to *R & G* was within the ambit of the object clause of the plaintiff's memorandum, and the defendant had no business to enquire as to whether the plaintiff has misapplied the loan. Furthermore, the defendant was, insofar as the object clause is concerned, not put on notice by any express requirement that the power to take a loan is only exercisable for the purposes of the company's business.

One is initially tempted to think that *s 20(1)* might have saved the bank; but that subsection deals with the capacity and powers of the company; and does not, on a plain reading of that subsection, purport to save transactions in breach of the articles, and would have rendered no assistance, one way or the other, to the issue in question here.

Proceeding on with the discussion then, suppose the bank had had no knowledge, that would have been the end of the matter, and the Rule in *Turquand's* case would have come to the aid of the bank. But what if the bank knew of the breaches of the articles? The case of the *Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd*[120] tackles the issue.

In the *Bumiputra Merchant Bankers Bhd* case, the bank's counsel had candidly conceded that the bank had been fixed with the knowledge that there had been a *breach of procedure*. Assuming the company had discharged its burden of proving that the bank knew, then a number of consequences may have ensued

120 *[1988] 2 CLJ 445*

from this state of knowledge. The first is that the bank would have been under a duty to inquire upon the validity of the instrument in question, and that being the case, the Rule in *Turquand* would not have availed any relief to the bank, and the bank's cause of action would have been fatally flawed. That rule will be examined much later.

Secondly, under *s 20(2)* it is arguable that there may be relief afforded to the persons authorised to call upon the subsection (a member, a holder or trustee for debentures) if the act being sought to be restrained is executory. That is a moot point, however, for two reasons: the first is that *s 20(2)* commences with the words, *'Any such lack of capacity or power...'*. Here we are dealing with the issue of a breach of the article. Is a breach of an article something which creates a *'lack of capacity or power'* as such?

The traditional role of *ultra vires* is a concept rooted in the capacity of a company. 'Power' has been described, as we saw earlier, and however inadequately, as a 'means' of achieving the object. One apprehends that the purpose of the doctrine of capacity is one concerned with the company's transactions with outsiders.

A breach of articles does not affect the issue of capacity or powers involving a third party-outsider, this being a purely internal matter. Being an internal matter then, it merely gives rise to consequences which afford relief to insiders of a company, i.e. actions involving shareholders and directors. That would make the application of *s 20(2)* irrelevant in any event. If one is wrong on that score, and the opposite is true, then one has to move on to consider the opening words of *s 20(3)*, which are *'If the unauthorised act conveyance or transfer sought to be restrained under subsection (2)'*. The phrase *'unauthorised act'* seem to imply

that subsection (2), despite being defined as if it refers to acts beyond the *capacity* of a company, seems also to include acts in breach of the articles.

Thus it is arguable that *s 20(2)* and *s 20(3)* read together, will only aid a member, or a holder or trustee for debentures, if such person/s intend to challenge, and ultimately set-aside, an executory act. Such applications would have failed on the basis of the principle enunciated in *Hawkesbury Development Co Ltd v Landmark Finance Pty Ltd*,[121] that once a transaction is wholly completed it can no longer be restrained. Thus realistically, both subsections, are mere statutory palliatives, and are of no assistance to a member, or a holder or trustee for debentures, who are generally the last to find out about irregularities committed by those who control the company's Board.

Effect of directors' acts exceeding their authority

In the High Court case of *Public Bank v Metro Construction Sdn Bhd*,[122] one of the two *ultra vires* arguments raised by Metro was that the two impugned charges were created not for the benefit of the company but for the benefit of a third party, and that their creation was therefore outside the borrowing power of the company (conferred under *sub-cl 44*, i.e. *'To borrow, raise or otherwise secure the payment of money or loans by mortgage, guarantee, etc ... which may be beneficial to the company and for the purposes or for any lawful purpose ....'*).

The issue was in essence, whether the third party charges if created by the directors acting outside and beyond their powers would bind the company.

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121 *(1970) 92 WN (NSW) 199.*

122 *[1991] 1 CLJ 787*

Metro relied first on *article 102* of the company which empowered the directors to manage the business of the company and to exercise all the powers and to act on behalf of the company subject nevertheless to the provisions of the articles of association. The second article relied on, article 103 which stated *inter alia* that *'the directors shall have power to borrow or raise money from time to time for the purpose of the company.'*

Metro contended that, reading the two articles together, the directors of *Metro* could only borrow money for the *purposes* of the company and not, as it happened here, for a third party. Furthermore as the loans raised by the two charges were for the benefit of a third party, *sub-cl (44) of cl 3* of the memorandum had also been violated.

The learned judge then quoted the *dicta* of Lord Diplock in *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd & Anor*[123] and concluded that where a company has a general power to borrow money for the purposes of its business, a lender is not bound to enquire into the *purpose* for which the money is intended to be applied.'[124]

The other argument advanced by *Metro* was that the creation of the charges was in breach of *sub-cl 50* of the objects which had a clause that read: *'To guarantee or become liable to or give securities etc ... on account or instruction of the company'*. *Metro* argued that the two directors could not borrow money if the borrowed money was not used 'for the purpose or benefit of the company.' In rejecting this argument, Lim J said at page 795:

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123 *[1964] 1 All ER 630 at p 646,,*

124 Lim J cited two cases as authority for this proposition, namely the judgement of Lord Parker in *Brougham's case [1918] AC 514* , the *dicta* in *Re Introductions Ltd's case [1969] 1 All ER 887* both of which were reiterated by Browne-Wilkinson LJ in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation & Ors [1986] 1 Ch 246 at pp 305-306.*

On the principle laid down *in Brougham's case [1918] AC 514* and *Re Introductions Ltd's case [1969] 1 All ER 887* cited earlier, I do not think such a contention can be sustained for that principle certifies that 'where a company has a general power to borrow money for the purposes of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied.' This principle is reiterated by Browne-Wilkinson LJ in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation & Ors [1986] 1 Ch 246 at pp 305-306:*

> In my judgment, the propositions in the last two paragraphs accord with the decisions in *In re David Payne & Co Ltd [1904] 2 Ch 608 and Charterbridge Corporation Ltd v Lloyds Bank Ltd [1970] Ch 62.* As Slade LJ has pointed out, in the David Payne case the objects clause of the company stated expressly that the power to borrow was 'for the purposes of the company's business,' yet the borrowing (which was not in fact for the purpose of the company's business) was held not to be *ultra vires*. Buckley J at p 612, plainly treated the provision as a power, not an object. Vaughan Williams LJ held, at p 615, that the fact that the validity of the debenture depended on whether or not the lender had knowledge of the impropriety showed that the transaction was not *ultra vires*. Moreover, it was held that, knowledge being a necessary requirement to render the loan unenforceable, the lender was not put on inquiry whether the money was being borrowed for the purposes of the company's business, notwithstanding that the power to borrow was expressly limited to borrowing for those purposes. That case, therefore, is clear authority for two propositions: (1) that where there is a power to borrow for the purposes of the company's business (even if contained in the objects clause) and the borrowing is made otherwise than for those purposes the borrowing is not void as being *ultra vires*: and (2) a third party is not put on notice by an express requirement that the power is only exercisable for the purposes of the company's business.

The judge rejected that contention concluding that at the time the charges were executed (13 December 1984) the bank had had no knowledge of the alleged fraud

committed by the two rogue directors. The action for an order for sale had been commenced almost 2 years later (20 March 1986). Dealing with the question of excess of authority, the judge reasoned that the fraud committed by the two directors against the shareholders and the excess of authority on the part of the said directors was a matter only between the directors and the shareholders. Lim J said that a mere excess of authority was insufficient to vitiate the transaction between the bank and the company. In order to afford a defence, Lim J said, relying on the authority of *The Royal British Bank v Turquand 119 ER 474,* illegality had to be proven.

Unfortunately, the learned judge did not answer the question posed. Nevertheless, were one to assume that the third party charges were *ultra vires* the company's memorandum and articles of association, Lim J said that the transactions in questions were saved by *s 20(1)* of the *Companies Act 1965.*

Now, in the Singaporean High Court case of *Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd*[125], D'Cotta J, in considering the issue of *ultra vires* also dealt with the question of directors' authority.

In that case the plaintiffs claimed for a certain sum under a written Guarantee by which the defendants has guaranteed payment on demand of all moneys which were then or might thereafter be owing by a third party, one *Ta Leong Produce (Pte.) Ltd.* The claim was in respect of four advances made on Letters of Credit. The Guarantee, which was in compliance with clause 97 of the Articles of Association of the defendant, was executed by two directors of the defendants, Wong Kee Loh and Ong Say Beng. Wong owned more than 66% of the paid-up capital of Ta Leong at the material time. The official address of *Ta Leong* and the defendants was the same, and both offices shared the same premises with a glass

125 *[1981] 2 MLJ 58*

partition separating them and the name plates of the two offices were placed one on top of the other. Wong appeared to have disappeared in 1976. In so far as the Defendant company went, Wong had figured prominently in it. The defendant company had four directors, namely, Wong Kee Loh, Ong Say Beng, Hii Yii Pan and Tan Kian Kuen (of the latter three of whom no mention was made throughout the proceedings and who were thus presumed to have had no say in the running of the company). Wong and his wife owned 54% of the total amount of shares issued. The other directors owned the remaining shares.

The Defendant argued that Wong did not have authority, express or implied, to execute the Guarantee on behalf of the defendants. The learned judge said that in order to determine the issue of authority he had to peruse the evidence, the conduct of the parties and the surrounding circumstances at the time of the execution of the Guarantee. It turned out that Wong signed all the directors reports, balance sheets, cheques and Annual Reports. He was the managing director and the Chairman of the defendant company. The Plaintiff bank proved that 'Wong was the boss of the show' and was, in fact representing the defendants. The Plaintiff had made searches in the Registry of Companies and ascertained the position of Wong and his shareholdings before requiring the defendant company's Guarantee.

In adopting what is now known as the 'indoor management rule' enunciated in *Royal British Bank v Turquand*,[126] D' Cotta J said that where the persons managing a company do so in a manner consistent with its Articles and Memorandum of Association any persons dealing with the company, as were the Plaintiff-bank in the instant case, were not affected by any internal irregularities.

The learned judge then went on to tie-in his reasoning with the rule in *Turquand's* case, a case that is traditionally associated with the issue of agency,

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126. *(1856) 6 EL & BL 327; [1843-60] All ER Rep 435*

directors' excess of authority and the knowledge attributable to third party outsiders. This is what he said at page 59:

> Being the managing director of the defendant company as he then was, Wong had authority, it may be either express or implied and in this connection, that is what Lord Denning M.R. in *Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549, 583,* had to say:
>
> > it is express when it is given by express words, such as when a board of directors pass a resolution which authorises two of their number to sign cheques. It is implied when it is inferred from the conduct of the parties and the circumstances of the case.
>
> Having regard to the shareholdings of Wong and his wife together amounting to 54% of the entire issued share capital and having regard to the evidence of Hii Yii Pan himself [a defence witness] that each director had copies of the Memorandum and Articles of Association and the annual audited accounts of the company, there is no doubt that Wong had full power express, ostensible and implied to execute the Guarantee on behalf of the defendant company. Wong was also involved in opening an account for the defendant company with the Bank of America in February 1977 and arranging credit facilities to finance the export of timber from Sarawak, one of the two main commodities which the defendants dealt with—the other being pepper.

The Defendant had advanced arguments that just because one is a Chairman of the Board, a person could not, merely by virtue of his office, automatically bind the company. The learned judge, relying on the evidence said, at page 59:

> However I am fully aware that there are *dicta* in some of the English cases suggesting that a Chairman of a company does not have unlimited authority to bind the company merely by virtue of his office and it is for this reason that I earlier commented upon the fact that the execution of the Guarantee must he considered in the light of the surrounding circumstances

> prevailing at that time which, if I may reiterate, is this: Wong was the driving force of the company; he did what he liked by virtue of the fact that he owned the majority of the shares and apparently knew the business well while the others merely acquiesced to whatever was done by him. I am fortified in this view by the fact that when Hii Yii Pan [a defence witness] received AB1 (Pink) which is a letter of demand sent by the plaintiffs' solicitors to him, although he said in evidence that he was shocked when he received it, he did nothing about it which clearly indicates he was fully acquainted with the position and the letter came as no surprise to him. If in fact the Guarantee was executed without his knowledge he should in the normal course of business have reacted by denying its existence forthwith, repudiating it and even challenging its authenticity; however, he remained silent and did nothing.

The judge's reasoning in *Bank of Canton Ltd* , traverse effortlessly from the issue of knowledge (the concept of 'constructive notice' has been now abolished in England, but is arguably the reason why he cited the rule in *Turquand's case* in the first place) to that of the principle of authority, whether direct or ostensible. So much of the glossing over is apparent in the learned judge's *dicta*. This running-into of two rather different classes of principles, one being the equitable notion of notice, and the other being the common law creature of agency, and its employment in juxtaposition with the company law concept of *ultra vires* has characterised judicial opinion, both here and in Singapore. This seamless transition is apparent in other cases also, and these we must now examine.

The discussion now turns to the nuances of *ultra vires* transactions and the agent's authority.

Apparent and ostensible authority

In the case of *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd & Anor*[127] Diplock LJ (as he then was) set out the principle of authority in these words:

> An 'apparent' or 'ostensible' authority, on the other hand, is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority, so as to render the principal liable to perform any obligations imposed upon him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.

In ordinary business dealings the contractor at the time of entering into the contract can in the nature of things hardly ever rely on the 'actual' authority of the agent. His information as to the authority must be derived either from the principal or from the agent or from both, for they alone know what the agent's actual authority is. All that the contractor can know is what they tell him, which may or may not be true. In the ultimate analysis he relies either upon the representation of the principal, that is, apparent authority, or upon the representation of the agent, that is, warranty of authority.

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127 *[1964] 2 QB 480 at 503*

Further, Lord Diplock at p 644 drew a distinction between an 'actual' authority of an agent and an 'apparent' or 'ostensible' authority:

> An 'actual' authority is a legal relationship between principal and agent created by a consensual agreement to which they alone are parties. Its scope is to be ascertained by applying ordinary principles of construction of contracts, including any proper implications from the express words used, the usages of the trade, or the course of business between the parties. To this agreement the contractor is a stranger; he may be totally ignorant of the existence of any authority on the part of the agent. Nevertheless, if the agent does enter into a contract pursuant to the 'actual' authority, it does create contractual rights and liabilities between the principal and the contractor.
>
> An 'apparent' or 'ostensible' authority, on the other hand, is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted on by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority, so as to render the principal liable to perform any obligations imposed on him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation. The representation, when acted on by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.

This principle of law was quoted with approval in the High Court case of *Public Bank Berhad v Metro Construction Sdn Bhd*[128].

[128] [1991] 1 CLJ 787

That formulation of principle has now been established in the Commonwealth. Indeed Professor H.A.J. Ford, in the *Principles of Company Law* states at paragraph 532 with regard to the doctrine of ostensible authority:

> When a case arises in which the company denies that it gave, expressly or impliedly, authority to enter the transaction the company may nevertheless be held liable under the doctrine of ostensible authority, provided the contract is not *ultra vires* the company. Where the company holds out a person as having an authority that he might, consistently with the public documents, possess, a third party is in some cases entitled to assume that he has such authority.

As to how a company can make a 'representation' that a person has its authority, Diplock LJ states at page 504:

> ... where the principal is not a natural person, but a fictitious person, namely, a corporation, two further factors arising from the legal characteristics of a corporation have to be borne in mind.
>
> The first is that the capacity of a corporation is limited by its constitution, that is, in the case of a company incorporated under the Companies *Act*, by its memorandum and articles of association; the second is that a corporation cannot do any act, and that includes making a representation, except through its agent.
>
> ...
>
> The second characteristics of a corporation, namely, that unlike a natural person it can only make a representation through an agent, has the consequence that in order to create an estoppel between the corporation and the contractor, the representation as to the authority of the agent which creates his 'apparent' authority must be made by some person or persons who have 'actual' authority from the corporation to make the representation."

At page 505 Diplock LJ explains this lucidly:

> The commonest form of representation by a principal creating an 'apparent' authority of an agent is by conduct, namely, by permitting the agent to act in the management or conduct of the principal's business. Thus, if in the case of a company the board of directors who have 'actual' authority under the memorandum and articles of association to manage the company's business permit the agent to act in the management or conduct of the company's business, they thereby represent to all persons dealing with such agent that he has authority to enter on behalf of the corporation into contracts of a kind which an agent authorised to do acts of the kind which he is in fact permitted to do usually enters into in the ordinary course of such business.

The Federal Court in *Chew Hock San & Ors v Connaught Housing Development Sdn Bhd (1950-1985) MSCLC 145*, accepted this principle.

Thus it can be summarised that regard to the authority of the purported agent, *s 20(1)* of the Malaysian *Companies Act 1965*, would operate in this way:

1. *Actual authority*

   If an agent having the actual authority of the company enters into an *ultra vires* transaction, that transaction would be valid as against the company by virtue of *s 20(1)*.

2. *Ostensible authority*

   If an agent is shown to have the ostensible authority of the company and enters into an *ultra vires* transaction, that transaction would be valid as against the company by virtue of *s 20(1)*.

3. *No authority*

If a third party enters into a transaction with the purported agent, knowing that he does not have the authority of the company to enter into the transaction, it is submitted that transaction could not be saved by s20(1) and would be voidable for the third party would not have come to the transaction with clean hands.

Illegality and *Ultra vires*

In the Singaporean High Court case of *Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd*[129] the illegality point had been raised by the Defendants. *Section 133A* of the Singapore *Companies (Amendment) Act (No. 10 of 1974)*, had come into force on November 15, 1974, some $3^{1}/_{2}$ months after the entry into the Guarantee. The judge had dismissed the argument on the grounds that *s133A* had no retrospective effect. What if the Guarantee had been, in fact, signed after the section had come into operation?

Section 133A of the of the *Companies (Amendment) Act (No. 10 of 1974)* reads as follows:

> Subject to the provisions of this section, it shall not be lawful for a company:
>
> (a) to make a loan to another company;
>
> (b) to enter into any guarantee or provide any security in connection with a loan made to another company by a person other than the first-mentioned company, if a director or directors of the first-mentioned company is or together are interested in shares in

[129] *[1981] 2 MLJ 58*

the other company of a nominal value equal to one-fifth or more of the nominal value of its equity share capital.

In *Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd,* the Defendant, and the unrelated third party company Ta Leong, on whose behalf the Defendants had executed the Guarantee called upon by the Plaintiff, had a common director and shareholder, one Wong. It is relevant to note that the Guarantee, which was in compliance with clause 97 of the Articles of Association of the defendant, was executed by two directors of the defendants, one of whom was Wong, who owned more than 66% of the paid-up capital of *Ta Leong,* and with his wife he also owned 54% of the shares of the Defendant company. The registered address of *Ta Leong* and the defendants was identical. Had the guarantee been executed *after* November 15, 1974, it would plainly have been in violation of *s 133A.* His act of executing the guarantee would have been an illegal act.

In *Public Bank Berhad v Metro Construction Sdn Bhd,* Lim Beng Choon J had observed that in common law, a third party was not required to inquire into the capacity or any limitation of its directors' powers. When it came to the central issue in question, i.e. the borrowing of money, the learned judge had adopted the principle in *Re David Payne & Co Ltd [1904] 2 Ch 608* that where a company has a general power to borrow money for the purposes of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied, and the misapplication of the money by the company does not avoid the loan in the absence of the knowledge on the part of the lender that the money was intended to be misapplied. He then made a finding of fact that clause 3(31) of the objects was in fact sufficiently wide to enable *Metro* to carry on business akin to that of a financial institution. At page 794, he said that:

> Reverting to the object clauses of the memorandum of association of Metro, I have no doubt that the object under cl 3 sub-cl (31) is wide enough to indicate that one of the objects of *Metro* is to **carry on the business akin to that of a financial institution which, needless to say, includes that of raising money from loan by way of a charge on real properties.**

The difficulty that was adverted to at Chapter 3 against this particular finding of fact related to the application of *section 4* (read together with *s 2*) of the *Finance Companies Act 1969*. That *Act* although recently repealed, was in fact in force at the time Lim J had made the finding of fact as he did in *Public Bank Berhad v Metro Construction Sdn Bhd*.

If the company was carrying on the business of a financial institution at the material time, *Metro* would have been required, under the *Finance Companies Act 1969*, to obtain a licence from the relevant ministry. If there was no such licence, the act complained of would have been illegal, or at the least, prohibited by public policy. Had the learned judge been right in his finding of fact, then the defendant was bound to have succeeded, on the grounds of illegality, pleading a breach of *section 4* of the *Finance Companies Act 1969*. To explain this difficulty one has to turn to the *dicta* of Jemuri Serjan SCJ in the Supreme Court case of *Arab Malaysian Finance Berhad v Meridien Credit Corporation Ltd London [1993] 3 MLJ 193*.

In the *Meridien* case, the issues involved the interpretation of certain provisions of the *Borrowing Companies Act 1969 (Act No 6)* which later on, by amendment, was known as the *Finance Companies Act 1969*.

The appellant-defendant was a licensed borrowing company within the terms of the *Finance Companies Act 1969*. By a letter of guarantee dated 25 August 1980, the first defendant, in consideration of the plaintiff's [the respondent] agreeing, at

the defendant's request, to enter into or continue with shipping and/or commercial and/or financial transactions with *Malaysia Air Charter Co Sdn Bhd* ('the principal debtor') relating to the purchase of aircraft and spares by the principal debtor, agreed to guarantee the repayment to the plaintiff on demand, of all sums of money due and owing to the plaintiff by the said principal debtor arising out of any transactions aforesaid or otherwise, together with all costs, etc of whatsoever nature provided that the total amount recoverable from the first defendant shall not exceed RM2.34m, exclusive of such costs, etc. The issue of the letter of guarantee was duly authorized by the Board of the first defendant. Subsequent to the issue of the guarantee, the plaintiff entered into financial transactions covered by the guarantee with the principal debtor, and in respect of the balance of the amounts owing by the principal debtor, the plaintiff obtained judgement against it *in Kuala Lumpur High Court Civil Suit No C1255 of 1984.* The first defendant denied liability under the guarantee on several grounds.

A number of points were raised for the determination of the Supreme Court as preliminary issues on points of law, two of which are listed here:

(1) whether the issuance of the guarantee dated 25 August 1980 by the first defendant to the plaintiff to secure the repayment by the principal debtor, of money due and owing by the principal debtor to the plaintiff is prohibited by the *Finance Companies Act 1969.;*

(2) whether the issuance of such guarantee was illegal, void or unenforceable

The appellant argued that the guarantee was not an investment as there was no application of money in the purchase of some property from which interest or profit was expected and which property was purchased in order to be held for the sake of income which it would yield, relying principally on *Wragg v Palmer [1919] 2 Ch 58* and *IRC v Rolls-Royce Ltd [1944] 2 ER 340,* and the provision of the

guarantee by the first defendant was *ultra vires* the *Finance Companies Act 1969*. Further, the appellant contended that the issuance of the guarantee, not being a borrowing business, was prohibited by *s 4* of the *Finance Companies Act 1969* and not being an investment, was therefore void and unenforceable by the operation of *s 24* of the *Contracts Act 1950*. The appellant relied on, *inter alia*, the authorities of *Chung Khiaw Bank Ltd v Hotel Rasa Sayang Sdn Bhd & Anor [1990] 1 MLJ 356* and *Yeep Mooi v Chu Chin Chua & Ors [1981] 1 MLJ 14*. It was also contended by the appellant that the guarantee was tantamount to granting to the principal debtor unsecured credit facilities, thereby enabling the debtor to receive cash, goods and/or services from the creditor or a third person and contravening the provisions of *s 20(1)* of the *Finance Companies Act 1969* which prohibited such transaction as a business.

The Supreme Court in fact decided that provision of the guarantee was not the 'primary' object of the company and thus the impugned transaction was not illegal, and that consequently the guarantee had not been rendered unenforceable by the *Finance Companies Act 1969*. This is what the Supreme Court observed at page 202:

> Here, in the instant case, we were confronted with two problems whose solutions depend entirely on facts to be established. Firstly, was the provision of guarantee necessarily a business in the context of the present case, and, if it was, was it carried on as the business of the appellant company?

The Court continued at the same page:

> In view of the welter of authorities on what constitutes business and what is the correct interpretation of the expression 'carrying on business', it would be necessary to consider the objects for which the appellant company was incorporated. In order to determine whether

> the issuance of its guarantee was a business or not and was carried on as such, it is incumbent upon us to examine the memorandum of association of the appellant company to ascertain what were its primary objects for which the company was incorporated.

In the event Jemuri Serjan SCJ concluded at page 207 of the report:

> ... it is our considered view that the provision of guarantees by the appellant company is not the primary object of the company, and by the same token, not its borrowing business. It follows that the issuance of the guarantee was not caught by the prohibition in s 4 of the *Act* and on the contrary, valid and enforceable against the appellant.

However that is not the crux of the illegality argument in respect of the *Public Bank Berhad v Metro Construction Sdn Bhd* case. For that argument one has to refer to the factual analysis on the applicability and ascendance of the *Finance Companies Act 1969* over the *Companies Act*, and one has to turn to pages 202 to 204 of Jemuri Serjan SCJ's judgement:

> The appellant company was incorporated under the provisions of the *Companies Act 1965* on 6 November 1968, as a private company limited by shares. By a resolution dated 12 December 1968, it was resolved that the appellant company be converted into a public company and was so converted on 14 December 1968. On the other hand, the *Act* came into force on 1 June 1969, by virtue of *(PU(B) 128/69)* which was after the incorporation of the appellant company. Therefore, at the time when the appellant company was incorporated as and converted to a public company, **the memorandum of association of the company was prepared and designed in such a way as to enable it to be engaged in the business of not only a strictly finance company, but also a company which was involved in a host of other business activities, not merely related to the business of a finance company.** The memorandum of association clearly testifies to these activities and thus contained a profusion of every conceivable form of activities such as ...(etc).

However, on the coming into force of the *Act [Finance Companies Act 1969]*, the appellant company, by virtue of *s 47(2)* of the *Act [Finance Companies Act 1969]*, was required to apply for a licence if it wished to continue to carry on the borrowing business which in fact it did. Thus, the appellant company became a licensed borrowing company. Under *s 49* of the *Act [Finance Companies Act 1969]*, it was provided that the *Act* shall be without prejudice to the provisions of the *Companies Act 1965* and that where there was a conflict between the *Companies Act 1965* and the *Act[Finance Companies Act 1969]*, the provisions of the latter shall prevail. In view of the provisions of this section of the *Act[Finance Companies Act 1969]*, the object clause in the memorandum of association of the appellant company must be examined in the light of the provisions of *s 2* which defines 'borrowing business' and *s4* of the *Act [Finance Companies Act 1969]* which prohibits the appellant company from carrying on business other than the borrowing business. It means that in order to determine the primary objects of the appellant company after the coming into force of the *Act [Finance Companies Act 1969]*, only those of the objects stated in the memorandum of association which conform to the requirements and/or fall within the scope of *s 2* would be regarded as the primary objects of the appellant company. The other clauses in the memorandum of association which do not conform and/or fall outside the scope of *s 2* must, of necessity, if they are relevant, be regarded as powers of the appellant company, while others that are not ancillary to the primary objects and fall outside the scope of *s 2* must necessarily be ignored and regarded as prohibited by virtue of *s 4*.

The distinction, in our view, between the primary objects and the powers of a company, is of importance here as it has a decisive bearing on the determination of this appeal. The memorandum of association should set out the purpose for which the company was formed to achieve and the kind of activities or business which it is to carry on. It is in the object clause of the memorandum of association that the perimeter of permissible activities of the company is set out, so that if it attempts to do anything beyond that perimeter, it is exceeding its objects and thereby acting *ultra vires*. On the other hand, the powers of the

company are ancillary to the main objects and are given to the company to enable it to carry on its primary objects or businesses.

One way in which the *Meridien* argument can be handled, if one is minded to save the *dicta* of Lim J in the *Metro* case (where His Lordship had in fact stated that *'I have no doubt that the object under cl 3 sub-cl (31) is wide enough to indicate that one of the objects of Metro is to carry on the business akin to that of a financial institution'),* the first step is to argue, as did Jemuri Serjan SCJ, that the objects of *Metro* were 'primary' objects which were in conformity with *s 2* of the *Finance Companies Act 1969;* and that these were not caught by the prohibition of *s 4* of the *1969 Act;* and then to continue the argument to its logical conclusion that *Metro* had the power—a power 'incidental' for the purposes of its primary objects and which was 'necessary' for the achievement of the primary objects—to function as a finance company .

We had observed that earlier in *The Royal British Bank v Turquand,*[130] the relevant principle therein cited in support of illegality was that if no illegality is shown as against an outsider with whom the directors contract under the seal of the company, excess of authority is a matter only between the directors and the shareholders. In relying on this *dicta,* Lim J said in *Public Bank v Metro Construction Sdn Bhd,*[131] that illegality had to be proven.

Be that as it may it ought to be observed that this splicing of the concept of *ultra vires* with that of excesses of directors' authority, as well as illegality, raises difficulties which are contrary to established principles.

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130 *119 ER 474*

131 *[1991] 1 CLJ 787*

When one considers acts, which are illegal, the consequences of such acts have been recognised for a long time prior to the establishment of the doctrine of *ultra vires* in English company law. An act that is illegal, whether it is illegal in the sense of being contrary to law or public policy, is void on general principle, and this has nothing whatsoever to do with the doctrine of *ultra vires*. The invalidity of the act depends on the well established principle enunciated by Lord Mansfield in the 1775 case of *Holman v Johnson*,[132] that no action arises out of an illegal act. In fact in *Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd*, in respect of *s 133A* of the Singapore *Companies (Amendment) Act (No 10 of 1970)*, the learned judge does make this pertinent observation at page 60 of the report:

> There is no reason or justification for giving the section retrospective effect. To do so would have invalidated overnight a large number of guarantees held by banks and others, in good faith as security, in Singapore and would involve a large number of perfectly respectable guarantors in the commission of criminal offences, a result which it is inconceivable the legislature could have intended without express terms.

This avowed intention to protect financial institutions in *ultra vires* cases and the confusion of the term 'illegality', as if it forms a limb of the doctrine of the term *'ultra vires,'* has regrettably been the bane of caselaw, whether in this country or in England, and ought to be avoided. *Ultra vires*, as a concept, ought only to denote acts that are truly beyond a company's capacity.

Ultra vires and knowledge of third parties

In some cases, the judges impute liability upon a company, because they feel that a company had been 'fixed' with the knowledge, on the basis of *ultra vires*, or on

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132 *(1775) 1 Cowp 341 at 343*

the grounds of illegality, or on the grounds of a breach of the articles of association, or of some constitutional or internal breach of procedure, or of impugned acts of other directors

In the *Bank of Canton Ltd v Dart Sum Timber (Pte) Ltd* case, D' Cotta J says, at page 60 of the judgement:

> From the evidence, I find that the Directors of the defendant company were fully aware that Wong Kee Loh had executed the Guarantee on behalf of the defendants and it was done with their consent and acquiescence. In the circumstances there will be judgment for the plaintiffs for the amount claimed with interest and costs.

This *dicta* may not be correct on principle, for knowledge of third parties dealing with the company is irrelevant, both on the basis of the rule in *Turquand's case* or the *Hely-Hutchinson* principle. The only possible exception to this principle of knowledge is the presence of illegality, which makes the act complained of void *ab initio*, and no action is maintainable, both parties being *in pari delicto*. In such a case, courts will not lend its assistance to either party.

He said that the two rogue directors may have been fraudulent was no reason to impugn the transaction. If the directors had acted fraudulently, or had exceeded their authority, that was a purely internal matter, as between the shareholders and directors. He said at page 794 of the CLJ report:

> ... it is to be noted that there is no plea that the bank had, at the material time, knowledge of the fraud committed by the two Yeohs against the shareholders of Metro. Neither is there any statement setting out facts from which such knowledge can be inferred. ...
>
> ...the said two directors had, in executing the two charges, acted fraudulently and in excess of their authority. But the fraud committed by the two directors against the shareholders

> and the excess of authority on the part of the said directors is a matter only between the said directors and the shareholders. ... I have no hesitation in rejecting the contention of counsel.

Lim J then dealt with the question of excess of authority. He said that a mere excess of authority was insufficient to vitiate the transaction between the bank and the company. In order to afford a defence to the company, he said, at page 795 of the CLJ report, illegality had to be shown, adopting the *dicta* in case of *The Royal British Bank v Turquand*,[133] where it is said at p 479:

> ... A mere excess of authority by the directors, we think, of itself would not amount to a defence. The bond being under the seal of the company, the gist of the defence must be illegality. If the directors had exceeded their authority to the prejudice of the shareholders by executing the bond, and this had been known to the obligees, illegality, we think, would have been shewn.
>
> ... If no illegality is shewn as against the party with whom the directors contract under the seal of the company, excess of authority is a matter only between the directors and the shareholders.

Where it is within the knowledge of the company itself, that knowledge is also irrelevant when the issue turns upon the question of *ultra vires*; for the words of *s 20(1)* are lucid; and admit of no exception, and barring illegality, the company is bound.

Now, in the case of *Executive Aids Sdn Bhd v Kuala Lumpur Finance Bhd*, the plaintiff-company had charged a piece of land to the defendant, as security for the repayment of a loan granted by the defendant to a third-party company called

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133 *119 ER 474*

Radio & General Trading Co (Holdings) Sdn Bhd ('R & G'). Following default in repayment of the loan by *R & G*, the plaintiff obtained an order for sale of the land by public auction under the provisions of the *National Land Code 1965*. In the present action, the plaintiff sought, *inter alia*, a declaration that the charge was void and/or unenforceable against the plaintiff and that therefore the order for sale was null and void and also an order that any auction pursuant thereto be set aside.

The plaintiff alleged that at all material times *R & G* and the plaintiff were not related to each other in any manner whatsoever, save that there were some common shareholders and directors. It was also alleged that the defendant knew that the companies were not related but nevertheless requested the charge to be created.

However, after the commencement of the proceedings before the Land Administrator, the plaintiff had negotiated with the defendant to settle the loan and did not raise the question of the validity of the charge before the Land Administrator. The plaintiff had requested the Land Administrator to postpone the sale a number of times, before the plaintiff finally brought the question of the validity of the charge to the court, a delay of two years.

It was not disputed that Wong a director of the defendant was also a director of the developer ('LSP') for whom *R & G* was working. On the other hand, one Arthur Chan was also the director of both the Plaintiff finance company as well *R & G*. It was contended that Wong as common director had knowledge of the fact that the loan was not for the benefit of the plaintiff and that such knowledge ought to be imputed to the defendant as well.

In particular, the plaintiff complained of the role of one Arthur Chan and one Wong Teck Lim ('Wong), and their state of knowledge in respect of the various transactions as between the parties. The Plaintiff referred to a certain discussion which its director Arthur Chan had with Wong.

As LSP had failed to pay *R & G* a sum of over RM1 Million for works done, Arthur Chan, who was at the material time a director of both the Plaintiff and of *R & G*, had approached Wong, a director of LSP and of the defendant finance company, to seek payment to *R & G*. At the meeting it was alleged that one Tan (a shareholder of the plaintiff) with the concurrence of Wong had suggested that *R & G* should obtain a loan of RM0.5 Million from the defendant, of which Wong was at the material time a director, so that *R & G* would have sufficient liquid funds to meet its pressing expenses incurred in carrying out the work on KL Plaza.

Thereafter it was alleged that Wong arranged for the defendant to lend RM0.5 Million to *R & G*. In consequence of the loan the defendant requested the plaintiff to charge its property to the defendant as security for the repayment of the loan. It is important to note that the suggestion was mooted by Tan, (who owned 78,871 shares of the plaintiff company); Wong merely concurred with the suggestion. The learned judge thought that it was an 'informal' meeting where Arthur Chan as director and on behalf of *R & G* sought payment from LSP.

The learned judge set out the salient facts, which appeared to have influenced his mind that there was nothing at all sinister in the role of Wong and Arthur Chan. He said at page 98:

> There was therefore no or at least not sufficient evidence to establish that Wong had concurred with the suggestion in his capacity as director of the defendant. Even to say that

Wong Teck Lim concurred with the suggestion in his capacity as director of LSP is rather tenuous simply because upon a request made by Arthur Chan for payment he, as director and on behalf of LSP, could only convey to the latter whether or not LSP could pay *R & G* all or part of the debts or could not pay anything at all. It follows therefore that Wong Teck Lim gave his concurrence to the suggestion in his personal capacity and nothing more. It is however suggested by the plaintiff that Wong Teck Lim 'later arranged for the defendant to lend RM0.5m to *R & G*'. But we have not been told what the nature of the arrangement carried out by Wong Teck Lim was to convince the managing director, the general manager and four other directors to approve the loan to *R & G*. All we have is a letter from the defendant ... approving the loan to *R & G* and the material terms are as follows:

...

From the aforesaid letter of approval of the loan to *R & G* it is clear that *R & G* applied to the defendant for a loan of RM0.5m payable within six months and as security for repayment of the loan *R & G* with the authority of the plaintiff offered to charge the property of the plaintiff for repayment of the loan. I will go even further and say that because Arthur Chan as director of *R & G* and the plaintiff company and Tan Jin Choon, a major shareholder of *R & G*, had given their personal guarantee concerning the repayment of the loan, the directors of the defendant company thereby agreed to approve the loan. More importantly is that the plaintiff had on 6 February 1986 executed and registered the charge of the plaintiff's property which had the seal of the plaintiff company and signed by its *pengarah* and *setiausaha*. The annexure to the charge instrument also had the seal of the plaintiff company and signed by one of its directors and secretary.

The Plaintiff contended that the defendant had knowledge (through their director Wong) or had, in any event 'constructive notice' of the non-relationship as between *R & G* and the plaintiff; and as a result the relevant charge had become unenforceable.

Lim J disagreed, and observed, at page 99:

> In such a situation where the defendant was merely approving the loan which was well secured by a charge of the plaintiff's property and the guarantee of two persons whom the defendant felt were trustworthy persons, can it be said that the defendant had notice of what transpired at the informal meeting between Arthur Chan, Tan Chor Eng and Tan Jin Choon on the one side and Wong Teck Lim on the other side? I think not.

Knowledge of irregularity and capacity in which it was received

In *Executive Aids* the memorandum had expressly allowed the creation of such charges. Thus, the position above taken by the learned judge in the case before him was correct. However the state of the knowledge, as opposed to how it had come to be acquired, are two different matters. Thus an identical argument as advocated by Lim J as aforestated, cannot be used to support a similar stand in circumstances where there was no such object or power given to the company.

In what manner the knowledge of any lack internal irregularity—or even a lack of capacity[134]— of the company becomes known to a third party, (whether at an informal meeting or an official one; and whether such information is acquired by the person concerned in his capacity as an employee, or as director etc.,) would be irrelevant to the issue in question.

The question that ought to be uppermost in the mind of the court is really: *'can the relevant knowledge—sufficient to vitiate the transaction—be imputed to the party pursuing the liability against the company?'* Thus even if the facts had been

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134 Would this not be cured by *s 20(2)?*

otherwise in *Executive Aids*, the capacity of, or the circumstances under which Arthur Chan and Wong had met, would have been irrelevant.

Now, in formulating an answer to the issue posed to him, the learned judge analysed two authorities, *Re David Payne & Co Ltd*,[135] and *Re Hampshire Land Co.*[136]

In the first case, *Re David Payne & Co Ltd*, one Kolckmann, who was a director of the *Exploring Land and Minerals Co.* Kolckmann also had financial interests in *David Payne & Co Ltd.* Having ascertained, in his private capacity, that that company (*David Payne & Co Ltd*?) proposed to borrow a sum of £6,000 for purposes outside the scope of its business, Kolckmann induced his own company (the *Exploring Land and Minerals Co*) to lend the said sum to that company on the security of a debenture of that company for the sum of £6,250 and the money was duly affirmed for purposes outside the scope of its business.

David Payne & Co Ltd had a general power of borrowing under its memorandum and articles of association but only for purposes of its business. No other director of *Exploring Land and Minerals Co* except Kolckmann knew how the money was intended to be applied.

Subsequently *David Payne & Co Ltd* was wound up. The liquidator applied to the court for a declaration that a second mortgage debenture for £6,250 purported to have been issued by that company to the *Exploring Land and Minerals Co* was *ultra vires* and void and did not constitute a charge on the undertaking or assets of the borrowing company.

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135 *[1904] 2 Ch 608*

136 *[1896] 2 Ch 743*

The liquidator argued that Kolckmann's knowledge ought to be imputed to the lending company. The trial judge Buckley J in rejecting it said at p 611 of the reported case observed:

> Under the circumstances, am I to say that the Exploring Land and Minerals Co had notice of what Kolckmann knew? I think not. I understand the law to be this: that if a communication be made to an agent which it would be his duty to hand on to his principals, who in this case, of course, were the Board of which Kolckmann was but one member, **and if the agent has an interest which would lead him not to disclose to his principals the information which he has thus obtained, and in point of fact he does not communicate it, you are not to impute to his principals knowledge by reason of the fact that their agent knew something which it was not his interest to disclose,** and which he did not disclose. I think, therefore, I ought not to impute to the Exploring Land and Minerals Co the knowledge which Kolckmann had.

A matter that deserves some thought is the state of knowledge of the company. Whether and in what manner the company came by the knowledge (which was sufficient to avoid the transaction) would depend upon whether it was communicated, and what had been the influence of the person through whom the information had been communicated (or could have been deemed to be communicated). Had Kolckmann been a mere employee of no influence whatsoever, it would be difficult to impute knowledge to his company. However, had Kolckmann been a man of considerable influence over the decisions of the relevant company, it would be easier to impute his knowledge to the company—for he would have, in everyday parlance, 'called the shots'.

The decision of Buckley J was upheld in the Court of Appeal; and Romer LJ said at pp 618-619 of the reported case:

The only other question is as to imputed notice. I take it that there was a transaction between the Exploring Land and Minerals Co and David Payne & Co of this kind. The first company lent 6,000l secured by a debenture of the second company. Now that transaction was *intra vires* the second company. But there was some evidence to shew that it was intended by some of the directors of the second company to apply the money for purposes not authorized and altogether improper qua the second company. **Now, one director of the first company knew how that money was going to be applied. He acquired that knowledge through some conversation which he had with some people in his private capacity before that transaction was carried out by the lending company. The question is whether,** inasmuch as that director took part on behalf of his company in authorizing the lending of the money and the acquisition of the debenture and assisted in carrying out that transaction, **the knowledge of that director so acquired is to be considered the knowledge of the lending company.** Is that knowledge as a matter of law to be imputed to the lending company? In my opinion no such notice can be imputed at law. I take it that in such a transaction the lending company was not bound to inquire as to the application of the money at all by the borrowing company. That being so, it appears to me **that knowledge independently acquired by a director in his personal capacity in respect to a matter which was irrelevant so far as concerned the lending company is knowledge which cannot be imputed to the company, for it was knowledge of something which really did not concern the lending company as a matter of law.** Therefore, you cannot imply a duty on the part of the director to have told these facts to the lending company, or a duty on the part of the lending company to have inquired into that question.

This part of the ration, by which the court seeks to impose or withhold knowledge sufficient to vitiate any transaction, is said to depend upon the rank or station or capacity of the officer. What difference does it make whether Kolckman acquired his knowledge in his 'private' capacity or in his 'professional' capacity or in his 'fiduciary' capacity? Can a man's brain be divorced from his memory? Surely this must be incorrect.

It would be interesting to conjecture how the court would have approached the issue had a majority—or even a substantial number of the decision makers – of the Board in question, had come by or had grounds to believe some knowledge, which would have been sufficient to render the transaction unenforceable. In such a case it would be difficult, as a matter of law, not to impute that knowledge to the company.

The second case which was analyzed in *Executive Aids* was *Re Hampshire Land Co.*[137] In that case the directors of a company were empowered to borrow money on its behalf. However they could not borrow money beyond the paid-up capital of the company unless they obtained consent at a general meeting. A general meeting gave the required consent but the notices summoning the meeting did not, as required by the regulations of the company, specify that borrowing beyond the limit was to be authorised by the meeting. The paid-up capital of the company was only £10,000 but the money borrowed from a lending society was in the sum of £30,000. The secretary of the lending society was also the secretary of the borrowing company.

The company was subsequently wound up. The society claimed to be entitled to prove in the winding up of the company for a debt of £30,000 for money lent to the company. Again the question to the court was whether the knowledge of the secretary could be imputed to the society.

Vaughan Williams J in *Re Hampshire Land Co* answered the question in the negative. He held that the money lent could be proved for in the winding up of the company. The grounds of his Lordship's decision appear in these words, at the headnote:

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137 *[1896] 2 Ch 743*

> Where one person is an officer of two companies his personal knowledge is not necessarily the knowledge of both the companies. The knowledge which he has acquired as officer of one company will not be imputed to the other company **unless he has some duty imposed on him to communicate his knowledge to the company** sought to be affected by the notice, and some duty imposed on him by that company to receive the notice; and if the common officer has been guilty of fraud, or even irregularity, the court will not draw the inference that he has fulfilled these duties.

In this second case, Vaughan Williams J takes the *'knowledge to be imputed depends upon the capacity of the bearer'* test to a higher level. In this respect, in effect what he seems to be saying is this: 'not only is that person's rank important, but it also depends on the level of duty to imputed to that capacity'.

As an officer of the company, and probably a fiduciary, and being under a duty to act in his company's best interests under the principle in *Smith & Fawcett Ltd*[138], such a person would have been obliged to protect it from a transaction which he could foresee might, in the future, give rise to complications to the company. So it is not clear why Vaughan Williams J in *Re Hampshire Land Co* thought that the communicator of the knowledge must have had *'some duty imposed on him to communicate his knowledge to the company'*. Why this kind duty is necessary before that knowledge is imputed to the company is not explained, and the principle is difficult to reconcile with the established doctrine of fiduciary duties.

Applying the principles enunciated by *Re David Payne & Co Ltd*, and *Re Hampshire Land Co*, cited above in the *Executive Aids* case, Lim J found as a fact that Wong Teck Lim had concurred with the suggestion of Tan Chor Eng in his

138 *[1942] Ch 304 at 306*

'private, personal capacity'. Since there was no evidence, the learned judge held that the former had disclosed what had transpired at the meeting with Arthur Chan to the other directors of the defendant, his knowledge of the loan to be given to *R & G* (to be secured by the charge of the plaintiff's property) could not be imputed to the defendant company.

The learned judge then referred to *s 20(1)*, and concluded that *s 20(1)* was applicable to the *Executive Aids* case, that section worked to render the third party charge valid, *'regardless of the knowledge acquired by Wong Teck Lim that the said charge was created not for the benefit of the plaintiff company which knowledge was not known to the defendant company.'*

Knowledge of third parties and *Rolled Steel*

Now, in *Executive Aids* the plaintiff again pressed the judge to consider the meeting of Wong and Arthur Chan, and relying on the case of *Rolled Steel* argued that in view of their knowledge, the third party charge was void. Distinguishing *Rolled Steel* from *Executive Aids* on the facts, Lim Beng Choon J went on to discuss the principles laid down in *Rolled Steel.* The attention the learned judge paid to the English Court of Appeal case merits serious discussion, as it concerned the effect of the knowledge of third parties upon any impugned transactions involving a company.

In *Rolled Steel Products (Holdings) Ltd v British Steel Corp & others*, the plaintiff company, Rolled Steel ('RSP'), carried on business as wholesalers of steel. The facts, which are somewhat convoluted, need to be recited to illustrate the imputation of knowledge of some irregularity on the defendant company, which knowledge eventually led to the defendant's prejudice.

The two directors of RSP were S and his father. S held 51% of the shares and the remaining 49% were held by three trustee-shareholders in trust for the benefit of S's children. Under *cl 3(k)* of the memorandum of association of RSP, it was empowered[139] to:

> lend and advance money or give credit to such persons, firm or companies and on such terms as may seem expedient ... and to give guarantee or become security for any such persons, firms or companies'.

S formed another company (SSS) and on behalf of that company entered into an agreement with C, a steel producing company, for SSS to act as distributor of coil and cut steel for C . The company C was later taken over by the British Steel Corp (BSC)).

S arranged for the RSP to set up a steel service centre for SSS to operate its business with some £400,000 borrowed from SSS Ltd. After the centre was erected SSS commenced operation by purchasing, on credit, large stocks of steel from C. SSS thereby incurred a debt to C amounting to some £860,000. It was a debt substantially in excess of its only significant asset, namely, the debt of £400,000 owed to it by RSP. When SSS failed to respond to pressure to reduce the debt, BSC, acting for C , first obtained a personal guarantee of the debt from S and then proposed that the plaintiff company, RSP guaranteed SSS's debt to C. The plaintiff company was known to have sufficient assets (including a leasehold land—the 'Rainham site'—valued at £850,000) to meet the debt.

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139 It is interesting to note how the Court of Appeal construed this clause. The Court of Appeal felt that *cl 3(k)* was a power; and that the power of the plaintiff company, under cl 3(k) of its memorandum, to lend and advance money 'on such terms as may seem expedient' was only a power and not a separate object. Furthermore, it was a power which could only be used for the furtherance of the objects of the company.

As a result a scheme was devised whereby C agreed not to press SSS for repayment of the debt and further agreed to lend the RSP the sum of £400,000 to repay its debt to SSS (which SSS was in turn to repay to C) in return for the RSP agreeing to guarantee the debt owed by SSS to C and to sell the Rainham site by a specified date and use the proceeds to repay the debt, failing which the plaintiff company would issue a debenture over all its assets in favour of C .

A board meeting of the plaintiff company was held on 22 January 1989: what transpired at the board meeting was crucial to the determination of the issues. At the board meeting, S and his co-director passed the necessary resolution approving the financial rearrangement and authorizing the guarantee and debenture. Under *Article 17* of RSP's articles of association, a director who declared his interest in a contract with RSP was entitled to vote as part of the quorum of two directors required for a board meeting. At that meeting, however, S did not declare to the Board, prior to the passing of the relevant resolution, or at all, that he had personally guaranteed SSS Ltd's debt to C.

Following the passing of the resolution and various payments, the debt owed to C was effectively passed from SSS to the plaintiff company RSP, which executed a guarantee in favour of C. The director S's liability under his personal guarantee was proportionately reduced.

When the Rainham site was not sold by the specified date the plaintiff RSP executed a debenture in favour of C. However, when a demand for the repayment of the debt was not met C appointed a receiver under the debenture. The receiver eventually sold the Rainham site for a sum sufficient to pay BSC the amount secured by the debenture and interest.

However after payment of other preferential debts there were insufficient funds left to meet the unsecured liabilities of the plaintiff company.

In these circumstances the plaintiff company brought an action against, amongst others, BSC and the receiver (the defendants) seeking a declaration that the guarantee and debentures were void and claiming repayment of the sum paid over to BSC by the receiver.

The plaintiff company, RSP, contended, *inter alia:*

(a) that neither the guarantee nor the debenture was a deed duly authorised or executed by the plaintiff company, because of S's failure to disclose his interest (namely, that his own guarantee would be reduced) at the Board Meeting of 22 January 1969 which had authorized the financial rearrangement; this meant that S was disqualified from voting at the Board meeting; which was consequently inquorate,

(b) that the guarantee and debenture were both *ultra vires* the plaintiff company and void, and

(c) that the directors of the plaintiff company had acted in bad faith in entering into the financial rearrangement, which fact was known to BSC; therefore BSC held the money received from the plaintiff company as constructive trustee and the defendants were liable in equity to replace that money.

The trial judge held (i) that the plaintiff company's claim that the guarantee and debenture had not been duly authorised failed in the face of the defence that the plaintiff company was to be assumed to have properly performed acts which were within its constitution to carry out, but (ii) that the guarantee and

debenture had been given by the plaintiff company for an unauthorized purpose, which fact BSC had been aware of and that the plaintiff company was therefore entitled to have those transactions set aside and the money repaid.

The appeal of BSC and the receiver was dismissed by the English Court of Appeal. The Court of Appeal discussed four inter-related principles which illustrates how the traditional concept of *ultra vires* as we know it function in a matrix of other—perhaps even unrelated—principles.

The English Court of Appeal held that the principle (and defence of BSC) that a company could be assumed to have properly performed acts which were within its constitution was not an absolute and unqualified rule of law applicable in all circumstances but only applied in favour of persons dealing with the company in good faith. Since C was to be taken as knowing that the Board resolution of 22 January 1969 would not be valid, unless pursuant to *Article 17* of the plaintiff's *articles of association* S had in fact declared his interest in the guarantee and the debenture, C was, on the facts, not entitled to assume without making further inquiry that S had in fact declared his interest. There was therefore no defence to the plaintiff company's claim that neither the debenture nor the guarantee were properly authorised deeds of the plaintiff company.

In applying that first principle enunciated in *Rolled Steel* to the facts before him in *Executive Aids*, Lim Beng Choon J found that there was no allegation that in approving the loan to *R & G*, any of *Executive Aids's* directors (one of whom was Arthur Chan) had failed to declare their interest in the transactions in questions i.e. the loan agreement and the third party charge created as security for the loan given to *R & G*.

In respect of the second principle, the Court of Appeal in *Rolled Steel* held that in order to be *ultra vires* a company transaction had to be done in excess of, or outside, the capacity of the company and not merely in excess or abuse of the powers of the company exercised by the directors. Accordingly, whether a transaction was *ultra vires* depended solely on the construction of the memorandum of association and whether the transaction fell within the objects of the company, properly construed. A transaction which was within the objects of the company or which was capable of being performed as reasonably ancillary or incidental to the objects was not *ultra vires* merely because the directors carried out the transaction for purposes which were not within the memorandum of association. Moreover, since the directors of a company were held out by the company as having ostensible authority to bind the company to transactions which, expressly or impliedly, fell within the powers conferred by the memorandum, a person dealing in good faith with the company was entitled to assume that the directors were properly exercising their powers for the purposes of the company and was further entitled to hold the company to the transaction.

Outsider's knowledge of excess of authority—company relieved of liability

However, if the company entered into a transaction which, although *intra vires* as being within its objects, was in excess or an abuse of the directors' powers the transaction could set aside at the instance of the shareholders; and a person dealing with the company who had notice, whether actual or constructive – that the transaction had been entered into in excess or abuse of the directors' powers – could not hold the company to the transaction and would be accountable as a constructive trustee for any money or property received by him from the

company. The power of the plaintiff company, under *cl.3(k)* of its memorandum, to lend and advance money 'on such terms as may seem expedient' *was only a power* and not a separate object and, furthermore, was a power *which could only be used for the furtherance of the objects of the company.* Since the guarantee and the debenture had been entered into in furtherance of purposes which were not authorised by the company's memorandum and were therefore beyond the authority of the directors and since that fact was known to C the plaintiff company was entitled to disclaim those transactions.

In *Executive Aids,* the learned judge, in applying this second principle in *Rolled Steel,* found as a fact that the defendant company did not have any knowledge that the plaintiff company executed the third party charge 'not for the benefit of' or not 'in furtherance of the objects' of the said company. The alleged knowledge acquired by Wong Teck Lim, one of the defendant's directors, could not be imputed to the defendant company. While the second principle enunciated in *Rolled Steel,* although pursued by the plaintiff was held not to be directly applicable to the *Executive Aids* case, it assists in the present discussion in eliciting the principle.

Knowledge, *ultra vires* and restitution

The third principle in *Rolled Steel* links the principle of restitution to that of knowledge and the doctrine of *ultra vires.*

In respect of the third principle, the Court of Appeal In *Rolled Steel* held that if the directors of a company had applied the company's funds in breach of the fiduciary duty they owed to the company, a third party who had received the

funds *with knowledge*—whether actual or constructive—of the directors' breach, must to be deemed to hold the assets as constructive trustee of the company.

The third principle was again irrelevant to the *Executive Aids* case, for the defendant company had no knowledge whatsoever of the breach of fiduciary duty, if at all, by the directors of the plaintiff company. Thus any breach of fiduciary duties on the part of the plaintiff company's directors was a matter, Lim Beng Choon J held, *inter se* the directors and the company's shareholders.

Relationship of equity to s 20 CA 1965 Malaysia

Notwithstanding the three principles discussed by the Court of Appeal in dismissing the BSC's appeal, nonetheless it went on to say:

> However, it was a principle of equity that where a third party's money was obtained by an agent's authorised act and applied for the benefit of the agent's principal the principal was liable to restore the money even though the third party knew the agent was not authorised to obtain or receive the money. Accordingly, it would be inequitable for the plaintiff company to be repaid the amount paid to SSS (to enable SSS to repay C) since although that payment was an unauthorized act by the directors the sum involved had been borrowed from C and the plaintiff company remained under an obligation to repay that sum to C.

In respect of this fourth principle of *Rolled Steel,* Lim Beng Choon J in *Executive Aids* aptly remarked at page 104 of the judgement:

> It is interesting to note that the Court of Appeal deemed it fit to turn to equity in order to ensure that the plaintiff company should not be allowed to retain the money paid by C. To

my mind the principle of equity as enunciated by the Court of Appeal is enshrined in *s 20(1)* of our *Companies Act 1965* which would prevent the plaintiff from complaining that the charge willingly created by them and which had the effect of inducing the defendant to give a loan to *R & G* is void and unenforceable.

The Indoor Management Rule and knowledge of third parties

In relation to the principle of *ultra vires*, it was seen in the English Court of Appeal case of *Rolled Steel* how third party outsiders who enter into a transaction with a company may be prejudiced by their own knowledge of any irregularity within the internal workings of the company. There is, however, a rule of law which has the reverse effect, and of long-standing history. The rule that persons dealing with a company in good faith may safely assume that such transactions have been properly and duly performed, and are not bound to inquire whether acts of internal management have been regular, is not a new principle.

That rule, having various appellations, and recently re-named the *Rule in Turquand's case*, will be examined, and its relationship to the doctrine of *ultra vires* determined in this section.

For example, the House of Lords in the case of *Morris v Kanssen*[140] said:

> ... But persons contracting with a company and dealing in good faith may assume that acts within its constitution and powers have been properly and duly performed, and are not bound to inquire whether acts of internal management have been regular.

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140 *[1946] AC 459*

In *Kredit Bank Cassel GmbH v Schenkers Ltd & Ors*[141] Atkin LJ said in, at p 430:

> If you are dealing with a director in a matter in which a director normally would have power to act for the company, you are not obliged to inquire whether or not the formalities required by the articles before he exercises that power have in fact been complied with. Those are matters of internal management – which an outsider is not obliged to investigate.

Lord Hatherley in *Mahony (Public Officer of National Bank of Ireland) v East Holyford Mining Co Ltd*[142] described that principle as 'the indoor management'. His Lordship stated that an outsider may assume that all is being done regularly *(omnia praesumuntur rite et solemniter esse acta).'*

The principle in *Turquand's* case (decided in the 1856 case of *Royal British Bank v Turquand),*[143] is that third parties having *bona fide* dealing with officers of a company, having apparent or ostensible authority, are under no duty to conduct an investigation as to the capacity or power of the company's officers.

In *Turquand,* the deed of settlement (corresponding to the modern articles of association) had given permission to borrow subject to a general resolution of the company authorizing the same. The bank had lent money to the company upon the security of a bond, signed by two directors, given under the seal of the company. In an action brought by the bank to recover the money lent, the company contended that no resolution of the requisite kind had been passed. In reply, the lender relied on the usual authority of directors. The Court of Exchequer Chamber held that the lender was entitled to succeed. This was because the company was bound by the contract since the bank was entitled to 'infer' that the necessary resolution had been passed.

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141 *[1927] All ER Rep 421*

142 *[1874-80] All ER Rep 427 at p 432*

143 *(1856) 119 ER 886*

The rule in *Turquand's* case protects third parties dealing with a company in good faith; and outsiders are entitled to assume that acts within a company's constitution and powers have been properly performed, and are not bound to inquire whether acts of internal management have been regular.

A proper exposition of the law can be found in *Palmer's Company Law,*[144] where the learned author states at page 247:

> According to this rule, while persons dealing with a company are assumed to have read the public documents of a company and to have ascertained that the proposed transaction is not inconsistent therewith, they are not required to do more; they need not inquire into the regularity of the internal proceedings.

Palmer explains the necessity for such a practical rule in the following words:

> This rule, which is based on a general presumption of law, is eminently practical, for business could not be carried on if a person dealing with the apparent agents of a company are compelled to call for evidence that all internal regulations had been duly observed. Thus, where the articles gave power to borrow with the sanction of an ordinary resolution of the general meeting, a lender who relies on this power need not inquire whether such sanction has in fact been obtained. He may assume that it has, and if he is acting bona fide, he will, even though the sanction has not been obtained, stand in as good a position as if it had been obtained.

In the Federal Court case of *Pekan Nenas Industries Sdn Bhd v Chang Ching Chuen & Ors,*[145] the rule in *Turquand's* case was discussed at length, and some parts of the judgement are discussed here.

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144 *(24th Ed) at p 247*

145 *[1998] 1 MLJ 465*

Edgar Joseph Jr. FJ, in delivering the judgement of the Federal Court, observed that the effect of the rule in *Turquand's* case was such as to reduce the enquiries which outsiders having dealings with a company—or more correctly outsiders who reasonably think they are having dealings with a company — must make.[146]

This reprieve as to the sort of knowledge attributable to third parties was said to be necessary to promote commerce; for otherwise parties involved in corporate transactions, purely to assure themselves that they are dealing with the right parties with right capacities, would be bogged-down attempting to verify that a mass of details were accurate.

The Federal court also looked at the rule in a different light. Such outsiders, it was said, did not have a right to insist on proof by the company's directors that every provision of its memorandum or articles had been complied with. The outsiders could not therefore be deemed to have constructive notice of some procedural failure, which they would have had no means of discovering.[147] This in fact was the legal basis for the rule.

Therefore where there are provisions in articles which required that the *'seal of a company shall be affixed only pursuant to a resolution of the board or a committee of the board and attested by a director and the secretary or a second director'*[148], even a breach or default of the same were said to be a matter of the company's internal management. The Federal Court declined to follow the *dicta* of English cases suggesting the contrary.[149] Therefore the fact that proper notice of a board meeting had not been given in advance to a director rendered the

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146 At page 505 of the judgement.

147 *County of Gloucester Bank v Rudry Merthyr Steam and House Coal Colliery Co [1895] 1 Ch 629 at p 636*, per Lindley LJ

148 *Table A Companies Act 1965 art 96*

149 *South London Greyhound Racecourses Ltd v Wake [1931] 1 Ch 496;* and *County of Gloucester Bank v Rudry Merthyr Steam and House Coal Colliery Co [1895] 1 Ch 629 (CA)*

meeting irregular, but that irregularity would not affect a third party if he had no knowledge of it.[150] Thus any transaction that the company had entered into with the outsider, despite the presence of any irregularity, would be binding on the company.

Edgar Joseph Jr. FJ said at page 505:

> This makes good sense because the outsider has no means of knowing whether the prescribed notices had been sent.

Such irregularities appeared to have influenced the High Court. In *Pekan Nenas* what was in issue was the validity of an alleged meeting of a family company held on 17 April 1990, in Singapore, attended only by the mother and the eldest son. The High Court made a finding that the father (and his faction of the family) had neither notice of the meeting nor were they served with the agenda for the same. The High Court said that the resolutions passed at that meeting, and the resolutions purporting to authorize the sale of the disputed properties to the Intervener/Purchaser (passed more than a month later), were irregularities sufficient to nullify all resolutions passed thereat. The High Court set-aside the sale of the disputed properties by the family company to the Intervener/Purchaser. The Court of Appeal upheld the decision of the High Court,[151] and Gopal Sri Ram JCA held:

> Given the finding of fact by the learned judge that the notice convening the meeting of 17 April 1990 was not served on the plaintiffs — a finding that I accept as being entirely proper — and having regard to the true principle of law that is to be applied, I am satisfied that the conclusion reached by the learned judge, namely that the meeting and all

150 *Browne v La Trinidad (1888) 37 Ch D 1*

151 *[1995] 2 MLJ 770 at p 806*

> the business conducted thereat were utterly void, is correct. .... The business conducted at the subsequent meetings of the first defendant's board are dependent for their validity upon the propriety of the meeting of 17 April 1990. That meeting having failed to stand up to curial scrutiny, these later meetings are also void and useless, and the learned judge was right in so holding.

The Federal Court, however, reversed the decision of both courts, and relying on *Browne v La Trinandad*[152] held that outsiders could not be affected—nor be penalised—for a thing which they had no means of knowing. The court went so far as to say that such an outsider may in fact depend upon the rule in *Turquand's* case. The effect of the rule, held the Federal Court, was to raise an irrebuttable presumption preventing a company from relying on internal irregularities. Edgar Joseph Jr. FJ said at p 505 of the report:

> With profound respect to the Court of Appeal, at the time of the execution of the sale and purchase agreement dated 3 December 1990, unless there was proof that the Intervener/Purchaser knew or ought to have known of the irregularities with regard to the meeting of 17 April 1990, ..., it is difficult to see how the contention advanced on behalf of the Intervener/Purchaser that it is entitled to rely on the rule in *Turquand's* case could have been rebutted.
>
> We note, in passing, that the trial Judge declined to validate the board meeting of the Family Company held on 17 April 1990 in Singapore, in regard to which the Father, the Second Wife, and the Father's Brother, were not given notice, on the ground that they had been prejudiced by the lack of notice. In so holding, the learned judge relied on *First Nominee (Pte) Ltd v New Kok Ann Realty Sdn Bhd & Anor [1983] 2 MLJ 76* which is authority for the proposition that the court's power to validate improperly-called

152 *(1888) 37 Ch D 1*

meetings under *s 355* of the *Companies Act 1965* cannot and will not be exercised where there is injustice to members who did not attend.

With respect, these considerations are irrelevant, where, as here, outsiders who believe they have entered into transactions with the company, are not aware if a board meeting is irregular because proper notice of it was not given in advance to each director, since they would not be affected by an irregularity if they have no knowledge of it *(Browne v La Trinandad (1888) 37 Ch D 1).* To put it another way, such an outsider may rely on the rule in *Turquand's* case which, when it applies, gives rise to an irrebuttable presumption, so that the company concerned is debarred from establishing or relying on the fact that the proceedings were irregular and unauthorized.

However the Federal Court went on to circumscribe the indulgence granted to the outsider by the rule in *Turquand's* case. The circumscription applied under two conditions; the first was the nature of the knowledge and the manner an outsider may come upon it; the second was the time when the knowledge in question had been acquired. Dealing with the second limb, the Federal Court held that the material time when there was knowledge, or means of knowledge, was at the time the outsider and the company had entered into the transaction. In so far as the nature of the knowledge was concerned, essentially three kinds of knowledge were said to prevent the invocation of the rule in *Turquand's* case. The first kind of knowledge was direct knowledge; an outsider who knew that there were internal irregularities in respect of the transaction could not seek to hide behind the rule; nor could one who would be put upon inquiry call the *Turquand* rule to his aid. The final category was attributable to an outsider who does not avail himself of the simple expedient of examining the pubic documents, which would be, in the circumstances, open to public inspection.[153]

[153] In *KL Engineering Sdn Bhd & Anor v Arab Malaysian Finance Bhd [1994] 2 MLJ 201 at p 209,* Dzaiddin SCJ, in relying on the *dicta* of Lord Simonds in *Morris v Kanssen [1946] AC 459* at 474 said that 'Form 49 (D14) is a public document to which the common law doctrine of constructive notice applies'.

This is what Edgar Joseph Jr. FJ said, at page 505:

> The rule in *Turquand's* case cannot, however, be invoked by an outsider who knows or ought to know that there is an irregularity.
>
> More particularly, outsiders dealing with a company who know that some relevant procedure internal to the company has not been followed cannot invoke the benefit of the indoor management rule (*see Howard v Patent Ivory Manufacturing Co (1888) 38 Ch D 156).* This is an exception to the rule in *Turquand's* case and the burden of establishing it lies on the party invoking the exception and in this case, that would be the Father and his faction. Furthermore, outsiders dealing with a company could also be affected by knowledge of facts which would put a reasonable person on inquiry; in other words, they would be deemed to know what a reasonable person would infer from known facts. So, for example, in *B Liggett (Liverpool) Ltd v Barclays Bank Ltd [1928] 1 KB 48* at pp 56-56, Wright J (as he then was) said:
>
> > Whatever may be the exact scope of the rule in *Turquand's* case, I think it is quite clear on principle and on the authorities I have already referred to that it can never be relied upon by a person who is put on inquiry. The rule proceeds on a presumption that certain acts have been regularly done, and if the circumstances are such that the person claiming the benefit of the rule is really put on inquiry, if there are circumstances which debar that person from relying on the prima facie presumption, then it is clear, I think, that he cannot claim the benefit of the rule ...

And, in *Morris v Kanssen & Ors [1946] AC 459,* Lord Simonds made it clear that an outsider cannot invoke the benefit of the *Turquand* rule if he is put upon inquiry. Here is what his Lordship said on this point (at p 475):

> He cannot presume in his own favour that things are rightly done if inquiry that he ought to make would tell him that they were wrongly done.
>
> So also, an outsider dealing with a company cannot invoke the benefit of the *Turquand* rule if he could or should in the circumstances have discovered the defect by inspecting the compulsory documents filed at the Registry of Companies which are open to public inspection. (See *Irvine v Union Bank of Australia (1877) 2 App Cas 366.*)
>
> The material time at which there must be knowledge or the means of knowledge is the time of entry into the transaction. (See *Kanssen v Rialto (West End) Ltd & Ors [1944] Ch 346; Morris v Kanssen & Ors [1946] AC 459.*)

There appears to be a fourth category of persons who cannot rely on the rule in *Turquand's case*. These are outsiders who deal with the minions within the corporate hierarchy. Gopal Sri Ram JCA, referring to Atkin LJ's *dicta* in *Kreditbank Cassel GmbH v Schenkers Ltd*[154] said, in the course of delivering the Court of Appeal decision,[155] at page 770:

> If, therefore, an outsider deals with an individual low in the corporate hierarchy, he cannot take advantage of the rule in *Turquand*. This is illustrated by the decisions of the Federal Court in *Chew Hock San & Ors v Connaught Housing Development Sdn Bhd [1985] 1 MLJ 350 at p 354*, and by the Supreme Court in *KL Engineering Sdn Bhd & Anor v Arab Malaysian Finance Bhd [1994] 2 MLJ 201 at p 209.*

But these are recent authorities, and in the two celebrated cases on *ultra vires* in Malaysia, delivered by Lim Beng Choon J, particularly in *Public Bank Berhad v Metro Construction Sdn Bhd,*[156] the court did not consider, nor had the benefit of

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154 *[1927] 1 KB 826 at p 844; [1927] All ER Rep 421 at p 430*

155 *Aik Ming (M) Sdn Bhd & Ors v Chang Ching Chuen & Ors and another appeal [1995] 2 MLJ 770*

156 *[1991] 1 CLJ 787*

hindsight of the *Pekan Nenas,* which had laid down guidelines in respect of the rule in *Turquand's case.* It would be interesting to go back in time and see what Lim Beng Choon J said in *Metro* and inquire whether his statements refer to the rule in *Turquand's* case, if at all.

In *Public Bank Berhad v Metro Construction Sdn Bhd,* Lim J had observed that in common law, a third party was *not required to inquire into the capacity or any limitation of its directors' powers.* The burden of proof, as can be garnered from the words of the learned judge, in proving that the third party *did not act in good faith,* fell upon the person asserting it. Where it came to the central issue in question, i.e. the borrowing of money, the learned judge adopted the *dicta* in *Re David Payne & Co Ltd [1904] 2 Ch 608* and followed by Harman LJ in *Re Introduction's Ltd [1969] 1 All ER 887 at p 890,* that where a company has a general power to borrow money for the purposes of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied, and the misapplication of the money by the company does not avoid the loan in the absence of the knowledge on the part of the lender that the money was intended to be misapplied.

Although the first half of this statement of principle (i.e. that 'in common law, a third party was *not required to inquire into the capacity or any limitation of a directors' powers')* sounds like the rule in *Turquand's case,* the learned judge made no reference—at all—to the rule in *Turquand's case* in *Metro.* What Lim J was presumably referring to was the capacity – or lack of it—in respect of the company. If he was, then why was there a need to 'inquire into' the *capacity 'or any limitation of its directors' powers'*? How would a lack of good faith affect the non-inquiry by a person who has been put on notice?

The learned judge made these observations at page 793 of the CLJ report:

The third general principle which is worthy of notice is that if a transaction is covered by the **object clauses**, a party to the transaction is not bound to inquire as to the company's **capacity** to enter into it or as to any such **limitation on the directors' powers** and the party will be presumed to have acted in good faith unless the contrary is proved. In *Brougham's case [1918] AC 514*, Lord Parker reiterated this principle at p 521 of the reported case:

> A person who deals with a company is entitled to assume that a company can do everything which it is expressly authorized to do by its memorandum of association, and **need not investigate the equities between the company and its shareholders.**

Lim J was not the only judge to fall into this error. In the recent case of *Abdul Fattah Mogawan & Anor v MMC Power Sdn Bhd & Anor*,[157] Kamalanathan Ratnam J, in adverting to the principle in relation to the doctrine of *ultra vires* said

> This rule[158] requires no further elucidation. In fact, such is the potency of this principle that it has been enacted into our *Companies Act 1965* as *section 20* which relates to *ultra vires* transactions. It is my judgment that the defendants ought not to be allowed to rely on internal arrangements or procedures to defeat the plaintiffs' claim, unless the defendants can prove that the plaintiffs had knowledge of such internal arrangements or procedures. This I find has not been done in this case.

While the citation of the rule in *Turquand's case* may be correct, it is obvious from the *dicta* of the learned judge how courts sometimes—erroneously, it is stated with deference— traverse from one principle to the other without adverting to the differing purposes, indeed the varied factual circumstances, out of which these two differing principle came to be born.

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157 *[1998] 5 CLJ 1*

158 Malick J was referring to the Rule in *Turquand's* case. But observe how he prefaces his discussion with the paragraph title, 'ultra vires'.

In a recent High Court case of *Thong Guan Co (pte Ltd) v Lam Kong Co Ltd (No.2)*,[159] the rule in *Turquand's case* was again raised as if it were a limb of the doctrine of *ultra vires*. The learned judge, Abdul Malick Ishak J said at page 734:

> **The *ultra vires* issue**
>
> This is an interesting issue. This formed an alternative defence and that defence was this: If the sale and purchase agreement was indeed executed, then it would not be valid and binding on the defendants, by reason of the fact that there being no evidence that Thong Kong Fye, the managing director of the defendants, and Koh Kok Peng, the secretary of the defendants, **were duly authorized to execute** the sale and purchase agreement on the defendants' behalf.
>
> Speaking generally, the cardinal principle of law distilled from *Turquand's case (Royal British Bank v Turquand (1856) 119 ER 886)*, would simply mean **that third parties having bona fide dealing with officers** of a company, **having apparent or ostensible authority, are under no duty to conduct an investigation as to the capacity or power of the company officers and are not required to inquire into the internal affairs of the company. Put differently, an outsider dealing with a company is entitled to assume that all matters of internal management and procedure have been complied with.** The rule in the *Turquand's* case is aimed at internal matters, proceedings and affairs of the company which are not within the knowledge of the outsider who can then assume that they have been complied with in full.
>
> ... Article 3(2) of the defendants Memorandum of Association as seen at p 86 of bundle 'A' stipulates in no uncertain terms the defendants' right:
>
> To purchase or otherwise howsoever acquire for investment or resale, and to traffic in land and house and other property or of any tenure and any interest therein and to

159 *[1998] 7 MLJ 720*

create, sell, and to make advances upon the security of land or house or other property or any interest therein by way of mortgage or otherwise, and generally to deal in, traffic by way of sale, lease, exchange or otherwise with the land and house property and any other property whether real or personal whether for valuable consideration or not.

Conclusion

As can be seen from aforesaid *dicta*, the assumption that a collection of common law rules designed to facilitate certainty and efficacy in commerce (whether the rule in *Turquand's* case, or the body of rules as to authority of a company's officers, of the rules as to knowledge) and their subsequent forced conjugation, as if they all form a seamless body of the *ultra vires* doctrine, is not only conceptually erroneous but serves to resurrect the almost entombed doctrine of *ultra vires*. We saw in this chapter also how courts struggle with the issue of internal breaches of procedure and often misconstrue as an appendage to the doctrine of *ultra vires*.

It is a trend that is regrettable, but there is a reason for it. This confusion of tests, by co-mingling common law principles with issues involving the capacity of a company, is a manifestation of the difficulty the courts have had in jettisoning common law rules in favour of *s 20*.

It can also be seen that despite the operation of *s 20(1)* of the *Companies Act 1965*, which is claimed to have nullified the absolute effect of the doctrine of *ultra vires*, vestiges of the common law still cling tenaciously to the fabric of *s 20*. This is largely due to the fact that there are internal defects in the way our *s 20* has

been drafted; for it makes no provision for third parties dealing with companies, whether they deal with it in good or ill faith.

Thus there is still room for argument in Malaysia that any imputed knowledge of an irregular act on the part of any common directors may infect a security or loan transaction. Nonetheless, if we look at the bright side, at least these weapons are available to judges to contain abuse of powers by those in control of companies.

What is obvious from these cases is that the courts will not allow legal arguments based on *ultra vires*, constructive notice or knowledge—no matter how meritorious they are, whether in principle in argument, or however well supported by facts— to be used as 'engines of fraud' as it were, to allow companies to escape liability from financial obligations which they had willingly undertaken to bear. The courts have been consistent in their approach in emasculating the legally nullifying effects of these concepts in order to uphold credit bargains. If a case goes against this perceived resistance of the courts, one has to turn to the English Court of Appeal case of *Rolled Steel Products (Holdings) Ltd v British Steel Corp & others,*[160] although the final result of the case more than compensates from any perceived departure from judicial policy.

The Australians having long realised this error in their own provision in *s 20* of the *Uniform Companies Code*, and having repealed the Act, they have enacted, in *s 164 of the Corporations Law*, rules as to dealing of outsiders with the company. It is a neat arrangement of all the common law rules within the compass of one section. It even serves to protect shareholders against outsiders

160 *[1985] 3 All ER 52*

who do in fact know, or the simple means of acquiring, any knowledge of internal irregularities.[161]

For a better view of the Australian position we now turn to study how they have dealt with the doctrine of *ultra vires*.

161 See *s 164* of the *Corporations Law, Australia.*

Chapter 5

ULTRA VIRES IN AUSTRALIA

This chapter examines the development and present position of the doctrine of *ultra vires* in respect of Australian companies.

In considering corporate capacity in Australia, one refers to the law of companies incorporated under the *Corporations Law*, which is the current statute regulating the conduct of companies (or 'corporations' as they are known) in Australia. There are two other types of corporations other than companies known under the heads of chartered corporations, and statutory corporations. These latter two are distinguishable from each other, but this discussion does not refer to either of the latter kind of corporations, and confines itself to the law of companies and *ultra vires*.

In Australia it has long been recognised that if a company with limited capacity acting through natural persons does anything beyond its capacity, it is said to act in the popular sense of the phrase '*ultra vires*', meaning 'beyond its corporate powers'[162]. A contract entered into by a company for example, as a result of such an *ultra vires* act rendered the contract void. As a consequence third parties to the contract were unable to enforce the contract. Such was also the fate where there was a transfer of property or the creation of trusts. It thus became necessary for third party outsiders to such contracts to be satisfied that the company with whom they desired to enter into a transaction had the 'corporate capacity' to do so.

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162 *Darvall v North Sydney Brick & Tile Co Ltd (1988-1989) 14 ASCR 474, 6 ACLC 1095*

However, in Australia, the phrase *ultra vires* is used in two distinct ways: an act is said to be *ultra vires* in the 'narrow sense' when an act is outside the 'functions' of a company. The functions of a company are construed from the words the Act and from a consideration identifying which of them are objects, which of them are mere ancillary powers, and which of them are necessary for, connected with or incidental to the performance of any of these functions.[163] It is said to be *ultra vires* in the 'wider sense' when intermediaries act in excess of abuse of their authority.[164]

Historical background

Section 20 of the repealed *Uniform Companies Act 1961* [165]set down the law relating to *ultra vires* transactions. That act is no longer in force, and since 1984 a number of amendments have been made, culminating in 1990 the *Corporations Law*. In 1983 Australia abolished the concept of *ultra vires*, these took effect on 1 January 1984.[166]

Before 1 January 1984, a company's capacity was measured against the objects stated in the objects clause, which every company was required to state in its memorandum. Thus a company could only do acts which were necessary for or incidental to the achievement of the particular purposes stated in the objects clause.[167] There existed then a danger that a person, acting with the best of

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163 *Ford & Austin, Principles of Corporations Law, 7th Ed 1995, [12.080]p 483*

164 *ANZ Executors & Trustee Company Ltd v Qintex Australia (Recs & Mgs apptd) (1989-1990) 2 ASCR 676 at 686*

165 *Section 20(3) Malaysian Companies Act, 1965*

166 Two Judges in Malaysia in *Public Bank Berhad v Metro Construction Sdn Bhd [1991] 1 CLJ 787* and V.C. George in *Bumiputra Merchant Bankers Bhd v Supreme-QBE Insurance Bhd [1988] 2 CLJ 445* but this may not be true as Ultra Vires still exist in Malaysia.

167 This happened when the House of Lords chose to extend the application of the *ultra vires* doctrine to companies in the case of *Ashbury Railway Carriage and Iron Co v Riche (1875) LR 7 HL 653*. The doctrine was at one time only used, and specifically developed for, corporations created by statute.

intentions, could discover to his dismay that a contract or transaction was void under the principle of *ultra vires* if the transaction had departed from the objects of the company.

Even a ratification and adoption of the transaction by the entire body of shareholders in a general meeting, as we saw in *Chapter 1,* could not validate such a transaction, for a member, or all of them acting unanimously, could not confer a capacity upon a company that the legislature had chosen to withhold from it.[168] By the expedient of equity and common law, lenders had the limited recourse of subrogation where the company had raised an *ultra vires* loan for the payment of *intra vires* debts for example; or if the proceeds of the loan could be traced into the hands of company, the equitable remedy of tracing and recovery were available.[169] The operation of the principle proved inconvenient for companies which sought to expand their business by resorting to loan finance. Thus, at that time it was thought not proper for a company's objects clause to state that a company could do all that a natural person could do.[170] Drafters of company constitutions in Australia, like their brethren in England, began to include in the company's objects clause every conceivable kind of business activity and any future business transactions within the four corners of the objects clause.

Naturally the courts in Australia began to distinguish between true objects and ancillary powers. Thus if a court discerned the objects clause as entitling the company to further its business of making railway carriages, a paragraph authorising the purchase of land was not construed so as to enable a company to enter into housing development, but only to the extent of allowing the company to further its business in the making of railway carriages. As a means of

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168 *Ibid.*

169 *Ibid.*

170 *Re Crown Bank (1890) 44 Ch D 634 at 644*

overcoming this rather limited construction of ancillary powers drafters began including at the end of the objects clause, a provision by which they declared that every clause was an independent clause. That device was futile, particularly if the power was one which could not by its very nature exist a separate power; for example a power to borrow money or the power to distribute assets in kind to members.[171]

Thus, because a company was considered a creature of statute, objects clauses could not be altered at all.[172] However, now object clauses may be altered, and the approval of the court is necessary only where members or debenture holders of 10 percent of interest raise any objections.[173]

It was thought that by such obstacles and restrictions over the capacity of a company had the effect of protecting investor-members, who could rely on the fact that a company could only do those things which its constitution said it would. The idea was also to protect creditors, particularly debenture holders who advanced money on the strength of the company's perceived business activities. Soon there arose a view that the tension between the two competing interests of the investors of a company and the outsiders had to be balanced. Financiers particularly needed to be reassured that when companies defaulted in loan re-payments they would not be left in the lurch by a borrower-company's argument of a lack of capacity. They desired that regardless of these arguments, a borrower would be bound by the transaction's obligations.

The Australian legislature appears to have been influenced by the need to strike a balance between the free flow of commerce, which needs finance as a pre-

171 *Darvall v North Sydney Brick & Tile Co Ltd, (at 1098) supra*

172 Later they were made alterable, but only with the approval of court.

173 Under *ss 172(1),* and *172(8)* of the *Corporations Law.*

requisite, and public interest.[174] The Australian Parliament recognised that in commerce, casual traders could not be reasonably expected to check up upon every company's memorandum of association before deciding to enter into a deal with them. Companies needed to be held to their word—that required reform and to that area we now focus our attention.

Reform and abolition of the doctrine of *ultra vires*

The fist wave of major reform in the doctrine of *ultra vires* occurred by the enactment of the *Uniform Companies Act 1961* and *1962*.

That legislation also included in *Schedule 3* a list of powers[175], which any company was deemed to possess under *s 19* [176]of the *1961 Act*, unless the company's constitution expressly excluded them.[177] The present position in Australia is that any objects clause that a company chooses to have in its constitution, while not going to its corporate capacity, limits the company in the exercise of its powers.[178]

The words of *s 20* of *Uniform Companies* legislation are identical to the words of *s 20(1)* of the present Malaysian provision. The Australian provision provided that no act of a company was rendered invalid by reason only that the company was without the capacity to do the *Act*. Identical to the present Malaysian provision in *s 20(3)*[179] (which in fact derives its genesis from the *Uniform*

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174 See Ford & Austin, *Principles of Corporations Law, 7th Ed 1995, [12.080] p 485*, para 12.110

175 Very much akin to the Third Schedule of *s 19* of the *Malaysian Companies Act 1965*

176 Similar to *Sec. 19 of the Malaysian Companies Act, 1965*

177 This later became *Schedule 2* to the *Companies Act 1981 (Cth);* and was in turn replaced by *s 125* of the *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 (Cth),* which became effective on 1 January 1984.

178 However, a pre-1984 company that retains its pre-1984 objects clause may have restrictions on the exercise of its powers without the benefit of *Schedule 2*.

179 *s 20(3)* of the *Malaysian Companies Act 1965* provides that the court may if it is deemed just and equitable, set aside and restrain the performance of the contract and allow compensation for the loss or damage sustained

Companies Act 1961 and the United Kingdom's *Companies Act 1948*[180]), *s 20* of the *Uniform Companies* legislation provided that if the company began to act beyond its capacity, a member (or a holder of a debenture secured by a floating charge) may apply to restrain the company while the company's obligations were not fully performed. Under that section, if the court exercised its discretion to restrain the company, the court had a discretion to award compensation — but not anticipated profits—to be paid to the outsider who had dealt with the company.

However, Australia raced away from that position[181] by another set of amendments, By virtue of *s 34* of the *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 (Cth)* particularly amending the *Companies Act 1981 (Cth)*, and the respective *State Companies Codes.* The 1983 amendments were later clarified by in 1985 by virtue of *s 47* of the *Companies and Securities Legislation (Miscellaneous Amendments) Act 1985.*

These provisions are to be found in the *Corporations Law, Part 2.3, Division 1,* under the head of 'Legal Capacity and Powers'. From 1 January 1984, the new amendments applied in respect of any company incorporated in any state in Australia.

Under *s 159(1)* a reference to the doing of an act by a company included a reference to the making of an agreement by the company and a reference to a transfer of property to or by the company. To create greater certainty *s 159(2)* declared that:

> ... a reference to legal capacity includes a reference to powers.

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resulting from the setting aside and restraining of the performance of the contract but no anticipated profits shall be awarded.

180 Walter Woon, *Company Law 1988, p 4*

181 But Malaysia still stands in the shadow of *s 20* of the Australian *Uniform Companies* legislation to this day

By *s 160* of the *Corporations Law*,[182] Australia formally abolished the application of the doctrine of *ultra vires* to companies. The words of *s 160* are as follows:

> Object of sections 161 and 162
>
> 160 The object of sections 161 and 162 is:
>
> (a) to abolish the doctrine of *ultra vires* in its application to companies; and
>
> (b) without affecting the validity of a company's dealings with outsiders, to ensure that the company's officers and members give effect to provisions of the company's constitution relating to objects or powers of the company;
>
> and those sections shall be construed, and have effect, accordingly.

The effect of the abolition meant that the limited purposes of a company whether stated expressly in an objects clause or implicit in the nature of the company, would not deprive the company of capacity. Thus any act of a company could not be stated to be void because that act did not conform to its purpose. So the doctrine of *ultra vires* does not apply to a company as a doctrine that determines corporate capacity. That a company is said to have limited purposes, deriving from the words of its memorandum of association, or implied from the intention of its corporators, does not go to its capacity; and the traditional link between purpose and capacity has thus been broken.[183]

Any question as to a lack of capacity therefore can only arise in relation to corporate transactions before the cut-off date of 1 January 1984, when the new amendments came into effect in Australian company law.

This does not mean that a statement of objects is entirely useless, for there are still many companies in operation in Australia which have in their respective memoranda of association, objects clause of old. The presence of these object

182 No parallel law in Malaysia exist

183 Ibid.

clauses still continue to impose restrictions on the company; a subject to which we shall shortly turn. It will also be seen that the fact had a company had a purpose, or that in fact such a purpose could be discerned by implication, could—and apparently still does—affect the validity of any of its acts, with the result that a transaction in disregard of corporate purposes could be voidable.

Present capacity of Australian companies

Capacity of natural persons conferred on companies

Section 117(2) read as follows:

> 117(2) The memorandum of a company may state the objects of the company

Section 172(1) read as follows:

> 172(1) Subject to this section, a company may, by special resolution, alter the memorandum of the company:
>
> (a) if the memorandum contains a provision stating the objects of the company - by altering or omitting that provision;
>
> (b) if the memorandum does not contain a provision stating the objects of the company - by inserting in the memorandum a provision stating the objects of the company; or
>
> (c) in any case - by altering, omitting or inserting any other provision with respect to the objects of the company or any provision with respect to the powers of the company.

Thus while under the 1983 amendments a company had the option of deciding whether or not it desired to state its objects in the memorandum of association,[184] for the most part there was no real legal reason to do so.[185]

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184 By virtue of ss 117(2) and 172(1).

By virtue of the 1983 amendments, any company was, by virtue of ss 161 and 159(b) to have the full capacity of a natural person.

Section 159(b) states:

> In sections 160, 161 and 162:
>
> (b) a reference to legal capacity includes a reference to powers.

Section 161 states:

> 161(1) A company has, both within and outside Australia, the legal capacity of a natural person...

After granting a company the capacity of a full person, *s 161* goes on to list certain powers that natural persons may not have but which companies need; and this grant of specific powers does not serve to limit the powers as a natural person. These specific powers include the power to (1) to issue and allot fully paid-up shares; (2) to issue debentures, (3) to distribute the company's property among members, (4) to give security to by charging uncalled capital; (5) to grant a floating charge on the company's property, (6) to procure the company's registration or recognition as a body corporate outside its place of incorporation, and (7) to do any other act it is authorised to do by any other law. The corporate powers enumerated at (2), (4) and (6) are corporate powers that a natural person does not have, and so also power (5), for natural persons do not have the capacity to give floating charges.

However, despite this grant of the capacity of a natural person, there are things a natural person can do that a company cannot. A company cannot be granted a

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185 However some mining companies, and non-profit companies which wished to have the word 'Limited' dropped from their name; as well as companies formed to practice certain professions (under State Law) still need to state objects.

probate of a will; for an executor is required to take an oath before assuming the duties of an executor, and a company cannot take an oath. A company cannot appear and argue its own cases; a solicitor must represent it; and a company cannot be an employee under the law.

Over and above all these considerations arise the question of restraints on the dealings of the company. There are in Australia a number of mechanisms which control the dealings of the company and we now turn to look at these.

Restraints in dealings

Internal restraints on capacity

The grant to a company of the capacity of a natural person in *s 161* is not unfettered; and that section is to be read in conjunction with other provisions within the Corporations Law; for their effect is to modify, and even curtail, the overall effect of *s 161*.

This can be seen from the wordings of *s 161 (2)*, which appear as follows:

> 161(2) Subsection (1) has effect in relation to a company:
>
> (a) subject to this Act (other than subsection 162(1);
>
> (b) In a case where the company's constitution contains an express or implied restriction on, or an express or implied prohibition of, the exercise by the company of any of its powers - despite any such restriction or prohibition;
>
> (c) In a case where the memorandum of the company contains a provision stating the objects of the company - despite that fact; and
>
> (d) despite subsection 162(1).

probate of a will; for an executor is required to take an oath before assuming the duties of an executor, and a company cannot take an oath. A company cannot appear and argue its own cases; a solicitor must represent it; and a company cannot be an employee under the law.

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(a) subject to this Act (other than subsection 162(1);

(b) In a case where the company's constitution contains an express or implied restriction on, or an express or implied prohibition of, the exercise by the company of any of its powers - despite any such restriction or prohibition;

(c) In a case where the memorandum of the company contains a provision stating the objects of the company - despite that fact; and

(d) despite subsection 162(1).

The wording of *s 162 (2)* are as follows:

> 162(2) [power exercised contrary to restriction or prohibition] Where:
>
> (a) a company exercises a power contrary to an express restriction on, or an express prohibition of, the exercise of that power, being a restriction or prohibition contained in the company's constitution; or
>
> (b) the memorandum of a company contains a provision stating the objects of the company and the company does an act otherwise than in pursuance of those objects;
>
> the company contravenes this section.

When read together, the effect of *s 161 (2)* is to exclude the restrictions of *s 162 (2)*. This is because a company's excess of the constitutional restrictions on its powers merely has internal consequences; and does not go to affect its capacity, so as to cause loss to third parties who deal with it in good faith.

There are other provisions in the Corporations Law which state that a company may only do certain acts where they are authorized to do so by the articles of association;[186] and most related to financial dealings of the company, and serve to protect creditors. These include restriction on issuing redeemable preference shares under *s 192;* [187]alteration of share capital under *s 193;*[188] reduction of share capital under *s 195;* [189]and the repurchase or buying-back of shares under *s 206DA;* [190]the prohibition under *s 205* [191]of a company acquiring its shares, or grant financial assistance for the acquisition of its shares except under certain conditions.[192] So also, because of the need to preserve and maintain capital, and

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186 *s 20(1) of the Malaysian Companies Act 1965* however indicates otherwise

187 *s 61 of the Malaysian Companies Act 1965*

188 *s 62 of the Malaysian Companies Act 1965*

189 *s 64 of the Malaysian Companies Act 1965*

190 *s 67A(1) of the Malaysian Companies Act 1965*

191 *s 67A(2) of the Malaysian Companies Act 1965*

192 See *s 205(8)* of *Corporations Law.*

unlike the case of individuals, a company does not enjoy the same degree of freedom in disposing of its own properties.[193]

The effect of these factors are restrictive, and serve to limit the effect of *s 161(1).*

External restraints in capacity

Thus far we had discussed matters which restrain the capacity of a company within the *Corporations Law*; we now turn to external regulators to a company's capacity.

When a company breaches any general prohibition in the general law, it is of course, without more, acting beyond its powers. This has sometimes been referred to as acting 'ultra vires, but such expressions are apt to confound rather than explain the law.[194]

It has been said[195] that one reason for confining the expression 'ultra vires' to acts beyond corporate powers is found in cases where a member has been, in exceptional cases, been allowed by the courts to sue as a champion for the company on a claim which belongs not to the member but to the company. One such case has been where the company had been engaged in a transaction that is ultra vires. An example where it has been unsuccessfully argued that the exception applied is the case of *Australian Agricultural Co v Oatmont Pty Ltd (1992) 8 ACSR 255,* where the company's acts were in breach of general law, although the company did not lack corporate power. In that case a company called Oatmont, a shareholder of *Australian Agricultural Co (AAC),* sought a declaration, contending that under *s 38A* of the *Crown Lands Act 1979 (NT),*

193 See *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd (1990) 2 ACSR 676.*

194 See *Australian Agricultural Co v Oatmont Pty Ltd (1992) 8 ACSR 255*

195 Ford & Austin, Ford & Austin, *Principles of Corporations Law, 7th Ed 1995, [12.080] p 488,* para 12.150

AAC could not have an interest in pastoral land exceeding 12, 950 square kilometers in area. The penalty for the breach was a fine of $100 per day and a forfeiture of the leases. AAC argued that its acts were lawful. The Crown refused to grant a fiat to Oatmont to pursue the action, and was also not interested in proceeding against AAC. The cause of action of the plaintiff Oatmont was a personal action, but it was not seeking any damages. The Court of Appeal held that no personal action could be maintained on the basis that there would be, as a result off AAC's breach of the general law, a diminution of the Oatmont's share values. The Court of Appeal felt that it would be oppressive to allow a shareholder, where personal rights were not affected except as to a possible diminution in the value of his shares, and who is unable to bring a derivative action, to seek declaratory relief.

The company's interests as a restraining mechanism

In the *Australian Agricultural Co v Oatmont Pty Ltd (1992) 8 ACSR 255,* counsel for the Plaintiff shareholder had argued that that illegality of conduct is ultra vires the company under general law, in the so called 'wide' sense of ultra vires, the distinction being between corporate incapacity (ultra vires in the 'narrow' sense) and abuse of powers by directors and shareholders (ultra vires in the 'wide' sense). To claim that a company acts ultra vires when it is in fact engaged in illegality is conceptually incorrect. That act is in excess of the general law and is to be impugned for that very reason, and not be struck down because it is said—however incorrectly—on the basis that it is ultra vires.

However it is not this misunderstanding that is now addressed, but how in fact Mildren J, in delivering the judgement of the Court of Appeal addressed this submission. His Lordship distinguished[196] the dichotomy between the wide and

[196] at page 262 of the judgement

narrow view of ultra vires, which he said had arisen in the context of legislative changes produced by *ss 160—162* of the *Corporations Law.*

He then quoted the case of *ANZ Executors and Trustees Co Ltd v Quintex Australia Ltd (1990) ACLC 900* where Mc Pherson J had observed at page 988-989:

> In *Plain Ltd v Kinley & Royal Trust Co (1931) ! DLR 468 at 479,* Orde JA spoke of ultra vires 'not in the primary application to the powers of a company as a corporate body , but in its secondary application to the irregular exercise by the directors or the shareholders of their powers or rights within the company ...' In several recent English decisions notably *Rolled Steel Products Ltd v British Steel Corporation [1982] 3 All ER 1057 at 1977* a similar distinction is made between corporate capacity (ultra vires in the narrow sense) and abuse of power by directors or shareholders (ultra vires in the wide sense). It is ultra vires in the **second sense** that is directly relevant in answering the question **whether a disposition of the property of the company was made for the benefit and to promote the prosperity of the company'**. This distinction was adopted by the Browne-Wilkinson LJ in the *Rolled Steel* case on appeal *[1986] Ch 246,* in a passage adverted to by Mason CJ in *Northside Developments Pty Ltd v Registrar-General (1990) 8 ACLC 611 at 621; 1990 64 ALJR 427 at 433;* see also *Darvall v North Sydney Brick & Tile Co Ltd (No.4) (1988) 8 ACLC 1095 at 1103-4; (1988) 14 ACLR 474 at 483.* The judgement of Vinelott J at first instance in the *Rolled Steel* case was responsible in Australia for the amending insertion in *1985* of *s 67(3)* of the *Companies Code,* which declares:
>
> > '67(3) The fact that the **doing of an act by a company would not be, or is not, in the best interests of the company** does not affect the legal capacity of the company to do the act'.

It is to this concept of the 'interests of the company' as a limiting mechanism to which we turn.

It is one of the general principles of company law that the board of directors are obliged to act in the best interest of the company. That principle is applicable not

only in England, where the principle was first enunciated in the case of *Re Smith & Fawcett Ltd*[197] but has common application in all jurisdictions in the Commonwealth. This principle applies to the exercise of all the powers of the directors, unless the articles state otherwise.[198]

The fact that the Board's act is not in the best interests of the company does not go to corporate capacity; but it can nevertheless make it an improper corporate act. There is however a distinction between 'excess of power' and an 'abuse of power'. A board may have all the powers to do a certain act, and it may, indeed act within those powers; but that act may amount to an abuse of powers. An example is provided by *Ford*.[199] Suppose the board has the power to spend company funds in connection with the elections of directors to the company. That power must of course be exercised in the best interests of the company. Should that power be used to promote a particular candidate endorsed by the Board, the exercise of that power cannot be in the best interests of the company; for it is but in the best interests of the Board. In this example the directors have acted well within their powers, but their purpose was not one sanctioned under the powers granted to them by the company's constitution; and the errant Board are said to have abused their powers. In the event a third party contracts with the company, and one of the signatories to the contract for and on behalf of the company is the director endorsed and elected by the abuse of company funds, and the outsider knows of these irregularities; then that contract is voidable by a newly constituted board, and is liable to be set aside.

In England, as was observed by Mc Pherson J in *ANZ Executors and Trustees Co Ltd v Quintex Australia Ltd*,[200] in several cases in which a transaction with an

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197 *[1942] Ch 304 at 306*

198 *Whitehouse v Carlton Hotel Py Ltd 160)1987) 160 CLR 285; 70 ALR 251; 11 ACLR 715.*

199 Paragraph 12.160 at page 489 of the 7th Edition.

200 *(1990) ACLC 900; (1990) 2 ACSR 676*

outsider was entered for improper purposes known to the outsider, it was decided that the transaction was not merely voidable, but void as being ultra vires the company. These cases were later known as cases of abuse of power by directors. The result of this nomenclature was significant, for it altered the consequence of the abuse; what were once void transactions merely became voidable; and this can be seen from the discussion in the *ANZ Executors* case.[201] In Australia that set of principles have been codified under section 161(3), which states:

> **161(3)** The fact that the doing of an act by a company would not be, or is not, in its best interests does not affect its legal capacity to do the act.

The wording of the section makes it possible for transactions effected by an abuse of powers known to the third party not void but voidable.[202] This means of course that if an outsider does not know of the abuse of powers, the transaction cannot be set aside.

Had the 1983 and 1985 amendments advanced merely the interests of outsiders?

The 1983 and 1985 amendments to the legislation, in giving full capacity to companies appear to have advanced, to a larger extent than that of the corporators, the interest of outsiders. In company law, the outsiders are generally potential creditors and institutional financiers. One writer, Watson,[203] argues that the alteration of the balance in favour of outsiders has removed a useful check on the improvidence of directors of the kind that was prevalent in the

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201 See for example page 686 of *(1990) 2 ACSR 676* .

202 Paragraph 12.160 at page 489 of the 7th Edition.

203 *Watson (1990) 8 C & SLJ 240*

1980s. Baxt[204] expresses the view that the Australian legislature has to reconsider whether the present weighting system in favour of outsiders is overly indulgent. He expresses concerns that the new amendments may in fact facilitate departures from commercial morality.

Be that as it may, it would appear that the Australian legislature intended that a company's internal regulations restricting the powers of organs and agents of the company should continue to protect members and existing creditors as much as possible. The legislative aim is in two sentences in *s 161,* i.e.:

> Object of sections 161 and 162
>
> 160 The object of sections 161 and 162 is:
>
> (a) to abolish the doctrine of *ultra vires* in its application to companies; and
>
> (b) without affecting the validity of a company's dealings with outsiders, to **ensure that the company's officers and members** give effect to provisions of the company's constitution relating to objects or powers of the company...

Indeed, despite the grant of full capacity to a company, the express words of the section appears to inhibit the officers and members of the company. This inhibition is in two respects: the first arises by the presence of internal mechanisms within the articles defining the authority of the Board; and that of the members; the second comes from the statutory words of the section itself; for the restriction expressly also applies to provisions 'relating to objects or powers of the company...'.

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204 *Baxt (1991) 19 ABLR 147.* In support of his view he points to dicta of the High Court decision in *Northside Developments Pty Ltd v Registrar-General (1990) 170 CLR; 93 ALR 385,* and the decision of the *ANZ Executors* case.

Self-imposed constitutional restrictions

Section 160(b) envisages that the object of *ss 161* and *162* is to ensure that the company's officers and members give effect to provisions of the company's constitution relating to objects or powers of the company. This is spelt out in greater detain in *s 162*, the relevant part of which is in these words:

> 162 [205]
>
> (1) [Restriction or prohibition in constitution]
> A company's constitution may contain an express restriction on, or an express prohibition of, the exercise by the company of a power of the company.
>
> (2) [power exercised contrary to restriction or prohibition] Where:
>
> (b) a company exercises a power contrary to an express restriction on, or an express prohibition of, the exercise of that power, being a restriction or prohibition contained in the company's constitution; or
>
> (b) the memorandum of a company contains a provision stating the objects of the company and the company does an act otherwise than in pursuance of those objects;
>
> the company contravenes this section.

Section 162(1) therefore allows the members of a company to limit corporate power by the imposition of express restrictions on how the organs of the company should exercise the power. Under *s 162(2)* the optional statement of the objects clause, when adopted, while not going to the capacity of the company, may operate as an express restriction or prohibition to limit the exercise of corporate powers by those who purport to act for the company.

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[205] Similar provision found in *s 30 and s 31 of the Malaysian Companies Act 1965*

On the other hand even though a company chooses not to state objects in its memorandum, it will normally have limited purposes. People do not form companies to do all possible things. The capacity of a company, in reality is limited by its purposes; and in this respect, a corporate entity cannot compare to a natural person. While the law is not concerned to limit the purposes for which natural persons exist, the law does concern itself with the purposes for which companies exist. Thus where a company chooses to have an objects clause in its memorandum of association, it is to that extent, limited in the exercise of its corporate powers.

Thus there are restrictive implications on the acts of the companies which breach these rules, whether statutory or common law rules, and we not turn to these.

Consequences of disregard to constitutional restrictions

The exercise of a corporate power contrary to an express prohibition or the doing of an act otherwise than in pursuance of the stated objects is a contravention of *s 162(2)*. An officer who is involved in a contravention of that sort breaches *s 162(3)—but* neither of these is an offence under the legislation. Such a contravention by the company or of the officer does not make the exercise of the power invalid. Ford observes[206] that because of the exclusion of *s 162(2)* from *s 161(2)(2)(a)*, and the subordination in *s 161(2)(d)* of *s 162(2)*, the contravention does not take the transaction outside the capacity of the company. There is a kind of contravention which can attract *s 1324* under which the court can grant an injunction to restrain the company from entering an agreement.

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206 See paragraph 12.200 at page 491 of the 7th Edition.

Position of outsiders

The position of outsiders is addressed by s 164,[207] which is in these words:

> **Persons having dealings with companies etc.**
> **164**
> (1) A person having dealings with a company is, subject to subsection (4),entitled to make, in relation to those dealings, the assumptions referred to in subsection (3) and, in any proceedings in relation to those dealings, any assertion by the company that the matters that the person is so entitled to assume were not correct shall be disregarded.
>
> (2) A person having dealings with a person who has acquired or purports to have acquired title to property from a company (whether directly or indirectly) is, subject to subsection (5), entitled to make, in relation to the acquisition or purported acquisition of title from the company, the assumptions referred to in subsection (3) and, in any proceedings in relation to those dealings any assertion by the company or by the second-mentioned person that the matters that the first-mentioned person is so entitled to assume were not correct shall be disregarded.
>
> (3) The assumptions that a person is, by virtue of subsection (1) or (2), entitled to make in relation to dealings with a company, or in relation to an acquisition or purported acquisition from a company of title to property, as the case may be, are:
>
> (a) that, at all relevant times, the company's constitution has been complied with;
>
> (b) that a person who appears, from returns lodged under section 242 or 335 or with a person under a law corresponding to section 242 or 335, to be a director, the principal executive officer or a secretary of the company has been duly appointed and has authority to exercise the powers and perform the duties customarily exercised or performed by a director, by the principal executive officer or by a secretary, as the case may be, of a company carrying on a business of the kind carried on by the company;
>
> (c) that a person who is held out by the company to be an officer or agent of the company has been duly appointed and has authority to exercise the powers and perform the duties customarily exercised or performed by an officer of the kind concerned;
>
> (d) that an officer or agent of the company who has authority to issue a document on behalf of the company has authority to warrant that the document is genuine and that an officer or agent of the company who has authority to issue a certified copy of a document on behalf of the company has authority to warrant that the copy is a true copy;
>
> (e) that a document has been duly sealed by the company if:
>
> (i) it bears what appears to be an impression of the seal of the company; and

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207 *s 127 of the Malaysian Companies Act, 1965 - Public Bank Berhad v Metro Construction Sdn Bhd [1991] 1 CLJ 787*, dealings with a company by officers and directors and *P. Balan and Talat Mahmood "Doktrin Ultra Vires dan Seksyen 20 Akta Syarikat 1965"* pg 25 1998. The Cohen Committee had recommended changes to the doctrine to protect person dealing with companies and the Jenkins Committee recommended the abolishment of the doctrine of constructive notice. However, both recommendations were not enforced.

(ii) the sealing of the document appears to be attested by 2 persons, being persons one of whom, by virtue of paragraph (b) or (c), may be assumed to be a director of the company and the other of whom, by virtue of paragraph (b) or (c), may be assumed to be a director or to be a secretary of the company; and

(f) that the directors, the principal executive officer, the secretaries, the employees and the agents of the company properly perform their duties to the company.

(4) Despite subsection (1), a person is not entitled to make an assumption referred to in subsection (3) in relation to dealings with a company if:

(a) the person has actual knowledge that the matter that, but for this subsection, the person would be entitled to assume is not correct; or

(b) the person's connection or relationship with the company is such that the person ought to know that the matter that, but for this subsection, the person would be entitled to assume is not correct;

and where, by virtue of this subsection, a person is not entitled to make particular assumption in relation to dealings with a company, subsection (1) ha no effect in relation to any assertion by the company in relation to th assumption.

(5) Despite subsection (2), a person is not entitled to make an assumption referred to in subsection (3) in relation to an acquisition or purported acquisition from a company of title to property if:

(a) the person has actual knowledge that the matter that, but for this subsection, the person would be entitled to assume is not correct; or

(b) the person's connection or relationship with the company is such that the person ought to know that the matter that, but for this subsection, the person would be entitled to assume is not correct;

and where, by virtue of this subsection, a person is not entitled to make a particular assumption in relation to dealings with a company, subsection (2) ha no effect in relation to any assertion by the company or by any other person i relation to the assumption.

Outsiders acting in good faith

Where a company had entered into an agreement with an outsider acting in good faith, the agreement cannot be impeached, under *s 162(7)(f)* solely on the ground that the company's management acted in breach of a constitutional

restriction, prohibition or a statement of objects. Under *s 162(8)*, even if a company could not be restrained by an injunction from carrying out the agreement into which it has entered, the company or its officers could be ordered to pay damages in an appropriate case where, in the absence of *s 162(7)*, the court would have granted an injunction.[208]

Under the Corporations Law, where a person has engaged, is engaging or is proposing to engage in conduct that would constitute a contravention of the Act has certain remedies under *s 1324*. *Section 1324* is in these words:

> **1324** **(1)** Where a person has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute:
>
> (a) a contravention of this Act;
>
> (b) attempting to contravene this Act;
>
> (c) aiding, abetting, counselling or procuring a person to contravene this Act;
>
> (d) inducing or attempting to induce, whether by threats, promises or otherwise, a person to contravene this Act;
>
> (e) being in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of this Act; or
>
> (f) conspiring with others to contravene this Act;
>
> the Court may, on the application of the Commission, or of a person whose interests have been, are or would be affected by the conduct, grant an injunction, on such terms as the Court thinks appropriate, restraining the first-mentioned person from engaging in the conduct and, if in the opinion of the Court it is desirable to do so, requiring that person to do any act or thing.
>
> **(2)** Where a person has refused or failed, is refusing or failing, or is proposing to refuse or fails, to do an act or thing that the person is required by this Act to do, the Court may, on the application of:
>
> (a) the Commission; or
>
> (b) any person whose interest have been, are or would be affected by the refusal or failure to do that act or thing;

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208 *s 9(1) European Committees Act 1972* protects dealings with an outsider in good faith by providing an assumption of good faith. *P. Balan and Talat Mahmood 's article "Doktrin Ultra Vires dan Seksyen 20 Akta Syarikat 1965* pg. 25 and 26. *s 35(1) United Kingdom's Companies Act 1989* (Dr. Prentice report on Ultra Vires lead to this amendment)

grant an injunction, on such terms as the Court thinks appropriate, requiring the first-mentioned person to do that act or thing.

(3) Where an application for an injunction under subsection (1) or (2) has been made, the Court may, if the Court determines it to be appropriate, grant an injunction by consent of all the parties to the proceedings, whether or not the Court is satisfied that that subsection applies.

(4) Where in the opinion of the Court it is desirable to do so, the Court may grant an interim injunction pending determination of an application under subsection (1).

(5) The Court may discharge or vary an injunction granted under subsection (1), (2) or (4).

(6) The power of the Court to grant an injunction restraining a person from engaging in conduct may be exercised:

(a) whether or not it appears to the Court that the person intends to engage again, or to continue to engage, in conduct of that kind;

(b) whether or not the person has previously engaged in conduct of that kind; and

(c) whether or not there is an imminent danger of substantial damage to any person if the first-mentioned persons engages in conduct of that kind.

(7) The power of the Court to grant an injunction requiring a person to do an act or thing may be exercised:

(a) whether or not it appears to the Court that the person intends to refuse or fail again, or to continue to refuse or fail, to do that act or thing;

(b) whether or not the person has previously refused or failed to do that act or thing; and

(c) whether or not there is an imminent danger of substantial damage to any person if the first-mentioned person refuses or fails to do that act or thing.

(8) Where the Commission applies to the Court for the grant of an injunction under this section, the Court shall not require the applicant or any other person, as a condition of granting an interim injunction, to give an undertaking as to damages.

(9) In proceedings under this section against a person the Court may make an order under section 1323 in respect of the person.

(10) Where the Court has power under this section to grant an injunction restraining a person from engaging in particular conduct, or requiring a person to do a particular act or thing, the Court may, either in addition to or in substitution for the grant of the injunction, order that person to pay damages to any other person.

Where an agreement is still being negotiated, an injunction could still be obtained by a member under *s 1324* to restrain the company from entering into the proposed agreement. The persons who may seek relief under *s 1324* are those whose interests have been affected by the contravenor's conduct. It would seem

that a member is said to have a right when he insists, by his application, that there ought to be 'due observance' of the restriction of the exercise of corporate power. A creditor with a charge on the company's undertaking and some voting rights was said to have the locus at common law in the case of *Hutton v West Cork Railway.*[209] Ford[210] observes that it is possible, under the ratio in *Allen v Atalay (1993) 11 ACSR 753* , for even an unsecured creditor to have rights under *s 1324.*

Outsiders with knowledge of excess of constitutional restrictions

There are no decided cases on this specific instance in the Australian courts but the words of s 164(4) are instructive:

> **164(4)** Despite subsection (1), a person is not entitled to make an assumption referred to in subsection (3) in relation to dealings with a company if:
>
> (a) the person has actual knowledge that the matter that, but for this subsection, the person would be entitled to assume is not correct; or
>
> (b) the person's connection or relationship with the company is such that the person ought to know that the matter that, but for this subsection, the person would be entitled to assume is not correct;
>
> and where, by virtue of this subsection, a person is not entitled to make a particular assumption in relation to dealings with a company, subsection (1) has no effect in relation to any assertion by the company in relation to the assumption.

209 *(1883) 23 Ch D 654*

210 See paragraph 12.210 at page 492 of the 7th Edition.

Conclusion

The new legislation under *sections 159* to *162* of the *Corporations Law* has abolished the doctrine of *ultra vires* in Australia, but only to the extent that the old doctrine rendered all transactions outside of the objects clause to be absolutely void.

Thus, outsiders who deal with the company in good faith cannot now have their transactions impugned, and the company's obligations set aside, purely on the ground that the company did not have the corporate capacity to enter into the transaction in question.

Such a person may however find that a member or a creditor may, under *s 1324* obtain an injunction to restrain the company from entering into a transaction on the ground that the impugned transaction is contrary to a constitutional restriction, a prohibition, or even a statement of objects.

In two circumstances a company may be saved; the first being a situation where the person who acts for the company completely lacks the authority;[211] or where the third party outsider has actual knowledge that the transaction is not for the benefit of the company.[212]

In conclusion we can now see how the Australian position is far more advanced than s 20 of the Malaysian Companies Act 1965, and how the *Corporations Law* has come a long way since the repeal of *s 20 of the Uniform Companies Act.*

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211 Any issue that is related to the avoidance by a company of transaction on the basis of a lack of authority is of course an entirely different body of law and is not pursued here.

212 See *s 164(4) Corporations Law*, and also *Howard v Patent Ivory Manufavturing (1888) 38 Ch D 156*

One admires the particular manner in which the Australian law has codified various common law rules into a single chapter of the Corporations Law, dispelling the nagging doubts about the relationship of *ultra vires* to certain established common law rules (some of which we saw at Chapter 4) which have invariably been the bane of other Commonwealth jurisdictions.

Perhaps the time is right for us to consider legislative reform of the Malaysian law.

Chapter 6

Conclusion

This chapter proposes to analyse the arguments put forth in Chapters 1 through Chapter 5.

Chapter 1 traced the development of the doctrine of *ultra vires* in England, and its position prior to various attempts at reform.

Before the United Kingdom *Joint Stock Companies Act 1856*, companies were formed on the basis of a *deed of settlement* – an elaborate form of partnership deed. The *Act of 1844* provided for the registration of the deed of settlement and the grant of corporate status in return.

The *1856 Act* introduced a new constitutional framework based on two documents – the *memorandum of association* and *articles of association* –loosely termed as the 'constitution' of the company. Of the two, the memorandum is the more fundamental in character;[213] for by its memorandum, a company proclaims to all the world the external aspect of its constitution, such as its name, *domicil*, objects, status,[214] and capital structure. On the other hand, the articles are concerned with matters of internal organisation of the members *inter se*, and

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213 See for example *Guinness v Land Corporation of Ireland Ltd (1882) 22 Ch D 349 CA*, a case which held that in the event of a conflict between the terms of the memorandum and that of the articles, those of the memorandum are to prevail. There are also statutory provisions in the UK Act, e.g. *s 125 CA 1985*, which make it possible to 'entrench' certain rights by writing them into the memorandum, with a prohibition or restriction on their alteration. Other provisions in the *CA 1985* also confirm the elevated position of the memorandum, whether by express words or by necessary implication, e.g. *ss 9*, and *17(2)*.

214 For example, whether the nature of the company is limited, unlimited, public or private. In Malaysia *s 18* of the *Companies Act 1965* [hereinafter *CA 1965 (Malaysia)]* lists out all the matters that are to be included in the memorandum. *Section 15 CA 1965 (Mal)* sets out the legal requirements of a private limited company.

in regard to their rights as against the company.[215] While the articles of association regulated the internal affairs of the company, of which the members were the absolute masters, any such alteration could not however, exceed the bounds set by the memorandum[216]. The situation is rather permissive today, for it is possible to alter virtually all the terms of the memorandum by resort to one procedure or another.[217]

An important provision in the memorandum, the 'objects clause', defined the capacity of the company. Up until 1948, in the United Kingdom, the alteration of the company's objects in its memorandum required confirmation by the court; but thereafter the present procedure under *s 4 CA 1985* was substituted in its place. [218] The UK *Companies Act 1985, s 2(1)(c)*, like every Companies Act ever since that of the *Joint Stock Companies Act 1856*, requires a company to include in its memorandum a statement of its objects. In Malaysia this requirement appears at *s 18(1)(b)* of the *Malaysian Companies Act 1965.*

The statement of the objects (or the 'objects clause' as it would later be known), was not developed for the benefit of creditors and shareholders alone; soon it became the basis of the development of the doctrine of *ultra vires*, a concept which would, for over a century afterwards, dominate legal thinking in company law. Indeed the vestiges of that doctrine remain to this day.

The *ultra vires* doctrine is a rule which is concerned with the *capacity* of a company. The doctrine imposed artificial limitations on the acts and things

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215 For example, the manner of holding shareholders and directors' meetings, the payment of dividends; the appointment, removal, retirement, and remuneration of directors, etc.

216 *Ashbury Railway Carriage and Iron Works Co Ltd (1875) LR 7 HL 653, per Lord Cairns.*

217 In Malaysia entrenched provisions may be altered by resorting to a Scheme of Arrangement under *s 176 CA 1965 (Mal).*

218 In Malaysia a number of provisions set out the procedure and the law in respect alteration of the objects clause. The main provisions are *ss 21* and *28 CA 1965 (Mal).*

which a company could – or could not – do. The thrust of the doctrine is set out in the *Ashbury Railway Carriage and Iron Works Co Ltd*[219], where Lord Cairns LC said that the *memorandum of association* is the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit. A company was thus incapable of doing anything outside the scope of its 'objects clause', or reasonably incidental to its 'objects clause',[220] and any act falling outside the stated objects of the company was not only beyond the authority of the directors, but beyond the capacity of the company itself, and a nullity at law; and could not even be ratified by all the members in a general meeting.

Shortly after the *Ashbury* case, realising that its decision in *Ashbury* may have been too narrow, the House of Lords relaxed the *ultra vires* rule a little in *A-G v Great Eastern Railway Co*,[221] and held that that in addition to the powers conferred by the memorandum, a company had power, even at common law, to do whatever could fairly be regarded as 'incidental to its objects'.

However, despite the fact that the doctrine has the effect of confining the activities of the company, it also constricted the company's powers, which raises the question of the distinction between the two: the line between objects and powers is an almost impossible one to draw.[222]

The strict application of the rule compelled drafters of company memoranda to use various ingenious devices; as a result of which the courts created a number of other restrictions, but this was to no avail.

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219 *(1875) LR 7 HL 653.*

220 This was a gloss put on the rule by *A-G v Great Eastern Railway Co (1880) 5 App Cas 473, (HL).*

221 *(1880) 5 App Cas 473.*

222 *LS Sealy*, 'Cases and materials in Company Law', 6th Ed. Butterworths, 1996, p 148.

The purpose for the development of the rule was said to be twofold.[223] The first is that the intending corporator who contemplates the investment of his capital ought to know within what field it is to be put at risk. The second is that an outsider who deals with the company ought to know whether the contractual relation into which he contemplates entering with the company is one relating to a matter within its corporate objects. Thus its purpose is to protect both the shareholder and third party outsiders. Eventually, because of the way commerce has developed in the world, the only third parties of any influence were financial institutions. When their suits to enforce the obligations of their corporate clients were filed, the defence the companies raised was that some objects clause had been breached, and that consequently the transaction was void and unenforceable. In some cases the companies argued that the powers of the directors were exercised outside of their express or implied limits of powers, or authority. Another argument used was that the documentation which signalised the bond of the parties, (whether in the form of a guarantee, an agreement or some company resolution), had been entered into in violation of some part of the memorandum or the articles. This was later called 'procedural' *ultra vires*. Companies sought to argue that even these second type of cases rendered void any transaction that was being enforced.

Then the celebrated case of *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*.[224] laid down a principle that served to untangle the legal imbroglio that had enmeshed the doctrine of *ultra vires*. The principle was that an act which comes within the scope of a power conferred expressly or impliedly by the constitution is not beyond the company's capacity by reason of the fact that the directors entered into it for some improper purpose. This *dicta* had a deep

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223 Lord Wrenbury in *Cotman v Brougham* at p 522

224 *[1982] Ch 478, [1982] 3 All ER 1057.*

impact all across the Commonwealth, and appears to have given the impetus for reformation, particularly in Australia.

Nevertheless, the confused jangle of rules constituting the doctrine had become so enmeshed in their own variations, and the lack of distinction in the objects/powers debate became so obtuse, that it became increasingly obvious that something had to be done to change the law.

Despite the recommendation of the Cohen and Jenkins Reports, no reforms were made to the doctrine. One of the reasons was that the UK Government at the time had recognised that to abrogate the *ultra vires* principle without at the same time modifying the Constructive Notice rule (that all persons dealing with a company were deemed to have constructive notice of its memorandum, or what is known as the constructive notice problem) would be pointless; for the other party to a contract would still be deemed to know that the *directors* has no *authority* to contract with him in a matter not covered by the objects clause. The constructive notice rule was thought far too important to jettison.

Forced by its accession in 1972 to the *Treaty of Rome* the UK Government accepted the First EC Directive in *Article 9* and enacted *s 9* (or *s 35 CA 1985),* which in principle proved unworkable. After the Prentice Reports in 1986, the United Kingdom enacted *s 35 CA 1985;*[225] and thereafter there were other provisions enacted; for example *CA 1985, s3A,* designed to encourage companies having commercial objects to abandon the traditionally voluminous objects clause. This did not work.

We also observed the rise and fall, but not the death, as it were, of the constructive notice rule. Along with any new amendments, the rule, established

[225] as amended by *CA 1989, s 108*

by the House of Lords in *Ernest v Nicholls,*[226] needed also to be abolished. But instead of a single provision consigning the rule to oblivion categorically and without qualification, United Kingdom has oddly catered for it in three provisions; namely in *s 416, CA 1985 , ss 35B* and *711A.* Thus under *s 35B,* for example, a party to a transaction with a company is not bound to enquire as to whether it is permitted by the company's memorandum (or as to any limitation on the powers of the board of directors to bind the company or authorise others) to do so.

However despite all these reforms the doctrine of *ultra vires* was not abolished: it survives, to this day, for some internal purposes.[227] In England, the doctrine also continues to apply to charitable companies[228] and to bodies not governed by the *Companies Acts,* such as municipal corporations, industrial and provident societies, building societies and friendly societies.

The sundering of the traditional connection between a company's objects clause and its capacity , however, did not, however, mean that those acting on behalf of the company will now have *carte blanche* to do as they like in the company's name. A member always had, in the past, a right to go to court to seek an injunction to prevent his company from entering into what would have been an *ultra vires* transaction. Such a right of a member is now codified and preserved in the new *s 35(2).*[229] And *s 35(3),* declared it to be the duty of directors to observe

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226 *(1857) 6 HL Cas 401*

227 For example, under *s 35(2),* a shareholder could bring proceedings to restrain the doing of an act which—but for subsection (1) —would be beyond the company's capacity. However, under *subsection (2),* no such proceedings could be commenced in respect of an act to be done in fulfillment of a legal obligation arising from a previous act of the company.

228 *s 35(4)*

229 Subject to a proviso for the benefit of third parties where the company is already committed by a legal obligation to perform the act in question.

any limitations on their powers flowing from the company's memorandum; and this is reinforced by a double-limbed provision relating to ratification.[230]

We also saw how abolition of the doctrine of *ultra vires* by *CA 1989* deprived the courts of the most potent of their traditional weapons when dealing with allegations that corporate property has been misapplied.[231] With the gradual erosion of the doctrine, the occasions on which the doctrine could be successfully invoked were destined to become rather fewer but it was used with considerable effect to deal with the most manifest cases of misappropriation.[232] With the demise of the *ultra vires* doctrine, the courts now employ other weapons in their armoury. It is possible to show, for example, that because directors have behaved unconstitutionally, or exceeded their authority, or abused their powers, or indeed acted in breach of their fiduciary duties, the transaction in question has been declared to be void or voidable. Both the directors and any third person who has received corporate assets with knowledge of the circumstances are liable to reimburse the company.[233] If the third party has dealt in good faith, for value and without notice of the irregularity, the company's remedy against him will, of course, be lost. There are other kind of breaches: for example a formal or informal breaches of directors' duty are not capable of ratification;[234] in some cases the power to ratify is restricted by statute;[235] and where the act involves illegality,[236] it will be wholly incapable of ratification at all.

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230 First, the act itself is now made capable of ratification, in contrast with the common law rule of non-ratifiability, but a *special* resolution from liability arising from a breach of this duty must also take the form of a special resolution, which must be separate from that effecting the ratification.

231 *LS Sealy, Cases and materials in Company Law*, 1996, 6th Ed, *p 415.* This is discussed at Chapter 1, p.41.

232 Such as *International Sales and Agencies Ltd v Marcus [1982] 3 All ER 551, [1982] 2 CMLR 46 (QBD).*

233 *Selangor United Rubber Estates Ltd v Craddock (No 3) [1968] 1 WLR 1555, [1968] 2 All ER 1073 (Chancery Division)*

234 *Cook v Deeks [1916] 1 AC 554 (Privy Council), Kinsela v Russell Kinsela Pty Ltd (1986) 10 ACLR 395 at 401.*

235 *CA 1985, s 35(3));*

236 For example a prohibited distribution under *s 263 CA*, or a breach of the 'financial assistance' prohibition under *s 151 CA 1985.*

What is obvious from these cases is that the courts will not allow legal arguments based on *ultra vires*, constructive notice or knowledge to be used as 'engines of fraud' as it were, to allow companies to escape liability from financial obligations which they had willingly undertaken to bear. The courts have been consistent in their approach in emasculating the legally nullifying effects of these concepts in order to uphold credit bargains.

So, despite the departure of the *ultra vires* doctrine, by resorting to various common law rules of ancient vintage the courts continue to thwart—and are still relatively well-equipped—to deal with cases of wrongful depletion of corporate assets.

In Chapter 3 we saw how the Malaysia legislature had approached the problem by enacting *s 20*, which is identical to *s 20* of the now repealed Australian *Uniform Companies' Act 1961*. The effect of the *ultra vires* doctrine is much diminished in Malaysia because of *s 20(1)*, which provides that if a transaction is otherwise valid and binding upon a company, the fact that it is *ultra vires* is irrelevant.

Nevertheless we also saw the ramifications in Malaysia caused by the application of *s 20*, along with other principles associated with—but largely distinct from—the law as to *ultra vires*.[237] We also saw how the Malaysian courts have struggled to extricate themselves from a mesh of old English principles, particularly those relating to the issue of internal breaches of procedure and which the courts have often misconstrued as an appendage to the doctrine of *ultra vires*.[238]

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237 This has been discussed at Chapter 3, from p. 93 onwards.

238 This has been discussed at Chapter 4, at pp. 152, and 155.

For example we saw how, in the 1993 case of *Arab Malaysia Finance Bhd v Meridien International Credit Corp Ltd London* the Supreme Court was constrained to distinguish between 'powers' and 'objects'. But having re-stated the principle the court then, arguably, went on to apply the objects-powers distinction argument to render valid the transaction in question.

We saw how a collection of common law rules designed to facilitate certainty and efficacy in commerce (whether the rule in *Turquand's* case, or the body of rules as to authority of a company's officers, of the rules as to knowledge) had been forcefully conjugated, as if they all form a seamless body of the *ultra vires* doctrine. This is conceptually wrong, and worse serves to disinter the almost entombed doctrine of *ultra vires.*

This confusion of tests, by co-mingling common law principles with issues involving the capacity of a company, is a manifestation of the difficulty the courts have had in jettisoning common law rules in favour of *s 20.* This only goes to show that *s 20* is insufficient for the purposes of making parties honour their deals. *Section 20* does not go far enough, and does not address what happens in the event the third party outsider has notice of any internal irregularity or breach of the relevant constitutional principles. In Australia *ss 162* and *164* of the *Corporations Law* have gone far to address this problem, and it will be well in Malaysia to pay heed to the considerations taken by the Australian legislature, and the law as it stands in the *Corporations Law.* However, the *ultra vires* doctrine does remain peripherally relevant in that any member or debenture holder secured by a floating charge (or trustee for such debenture holders) may sue to restrain the company from doing an *ultra vires* act.

However, the Australians have raced ahead and by way of various amendments between 1962 and 1989, they repealed the *Uniform Companies Code.* By way of a

number of amending legislations in 1983 and 1984 Australia enacted the *Corporations Law* which is the current law relating to companies today. The changes they made were sweeping, and conferred the capacity of a person to companies. They also moved to protect outsiders. In Chapter 5 we saw how the new legislation under *sections 159* to *162* of the *Corporations Law* had abolished the doctrine of *ultra vires* in Australia, but only to the extent that the old doctrine rendered all transactions outside of the objects clause to be absolutely void. In Australia at least outsiders who deal with the company in good faith cannot now have their transactions impugned, and the company's obligations set aside, purely on the ground that the company did not have the corporate capacity to enter into the transaction in question. In Malaysia we resort to this under the common law with various doctrines, as we saw in Chapter 4. In Australia however such a person may however find that a member or a creditor may, under *s 1324* obtain an injunction to restrain the company from entering into a transaction on the ground that the impugned transaction is contrary to a constitutional restriction. Under Australian law a company may be saved in two circumstances; the first being a situation where the person who acts for the company completely lacks the authority;[239] or where the third party outsider has knowledge that the transaction is not for the benefit of the company.

As we saw in Chapter 4 the courts had a number of weapons in their armoury in order to make parties keep their bargains; or otherwise there would be no certainty in commerce, and persons dealing with companies would have had to go to such extents to investigate the objects clauses that dealings with companies as corporate entities would cease. After the demise of *ultra vires*, the courts have resorted, quite typically, to other areas of the law in order to overcome the absence of *ultra vires*. The most notable of these is the knowledge of a third

239 Any issue that is related to the avoidance by a company of transaction on the basis of a lack of authority is of course an entirely different body of law and is not pursued here.

party, and this has come through many guises, and sometimes in unrelated ways. The principle of agency for example has been taken and turned inside-out and supplanted with a larger principle based on ostensible or apparent authority. In cases involving excesses of the Board or servants of the companies, the Indoor Management rule was trotted out as a defence. That later became known as the Rule in *Turquand's* case, and we saw how that rule has also been elucidated, and perhaps curtailed by the courts, particularly in the judgement of Edgar Joseph Jr. FJ in the case of *Pekan Nenas Industries Sdn Bhd v Chang Ching Chuen & Ors.*[240]

Nevertheless the courts often confuse *ultra vires* under *s 20,* the Rule in *Turquand's* case and arguments as to illegality as if they were interchangeable. We have seen how this unfortunate and regrettable trend has been recently repeated in two recent cases of *Abdul Fattah Mogawan & Anor v MMC Power Sdn Bhd & Anor,*[241] and *Thong Guan Co (pte Ltd) v Lam Kong Co Ltd (No.2).*[242]

Nonetheless, as a general principle any *ultra vires* transaction is no longer a complete nullity as of right. However, the express words of *s 20(1)* illustrate that the legislature recognises that there are certain areas of company law into which Parliament will not allow *s 20(1)* to interfere. For example, issues relating to illegality are not expected to be saved by *s 20(1),* even where the acts impugned were outside the object clause. In simple terms, *s20(1)* only saves transactions which are *ultra vires* the company. It would not save transactions that fall foul of other areas of the law e.g. breach of fiduciary duties of directors or illegality.

240 *[1998] 1 MLJ 465,* discussed at Chapter 4, p.145.

241 *[1998] 5 CLJ 1,* discussed at Chapter 4, p.153.

242 *[1998] 7 MLJ 720,* discussed at Chapter 4, p.154.

A question that has not been adequately answered by *s20(2)* is whether a member may rely on an *ultra vires* act or omission to wind-up a company, under *s 181*, (where, *inter alia* a member is entitled to petition the High Court for relief in cases of oppression); or under *s 218(1) Companies Act 1965*, (where a company may be wound-up under certain circumstances, one of which is based upon a complaint, *inter alia* that the directors of the company are conducting the affairs of the company in their own interests rather than in the interests of the members as a whole). *Ford* argues that in a *s 260 Corporations Law* application[243] to wind-up a company the applicant may assert a contravention of the company's constitution.[244]

It is time for us to learn from Australia, and instead of limping along with well-tested, but moth-eaten common law principles, perhaps we ought to, once again, avail ourselves of the Australian provisions by reform of the present *Companies Act 1965*.

243 Which appears to be similar to *s 218(1)(f)* application under the Malaysian *Companies Act 1965*

244 *Ford & Austin, Principles of Corporations Law*, 7th Ed 1995, at paragraph 12.230 at p 494.

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