Section 3. Commercial law

*Ms. Ismayilova Tahira Tahir,
(LLM, Kingston University London)
SMART Language Training Center LLC
E-mail: khazar.lawyer@gmail.com*

EVALUATION OF ANALYSIS OF SECTION 31(1) OF THE COMPANIES ACT 2006

Abstract: Critically evaluation of Analysis of “Section 31(1) of the Companies Act 2006 is a retrograde step in terms of a company’s capacity. The provision re-asserts the ultra vires problem encountered by creditors in cases such as *Ashbury Railway Carriage & Iron Co v. Riche* (1875) LR7 HL 653” with reference to the changes brought by the Companies Act 1989 and Companies Act 2006 in relation to company constitutions.

Keywords: the Companies Act, doctrine, memorandum, contract, authority, charter.

A new legislative structure for company law was introduced on 8 November 2006 in the United Kingdom. Further, the so called the UK Companies Act (hereinafter CA) 2006 also received assent from royal on 8 November 2006, which pioneered some unique transformation to the English Company Law. Both the section 31 and 39 of the CA 2006 of UK chiefly diminish the applicability of the doctrine of ultra vires to the company law, especially in the United Kingdom. However, the doctrine of ultra vires is still applicable to Charity Companies in UK. Thus, an injunction can be applied by member of a Charity Company, in advance only, to hamper an act which is supposed to be ultra vires [15, 40].

The acts that were ultra vires the competence of the company, and that could not be approved by seeking its member’s approval were first time differentiated by an English court in 1875. The phrase “ultra vires” refers the acts of the company which falls outside objects of the company. Ultra vires includes the acts of directors of the company who took the decision which falls outside the authority granted

to the directors under the articles of association of the company [9, 190]. In theory, the authorities of a company are restricted to those listed in the main objects clauses of its memorandum. If a company or its directors have done any acts, which fall outside the main objects of the company, then such acts will be regarded as ultra vires or void. This has been laid down in the famous *Ashbury* case [14, 191].

The House of Lords in *Ashbury Railway Carriage and Iron Co Ltd v Riche* held that a company did not possess the contractual authority to sign business contracts that fall outside the defined main objects of the company as defined in the memorandum of association. The Law Lords were of the opinion that this *Ashbury* rule would safeguard the interest of the outsiders who deal with the company [14, 191]. The directors of the company derive the authority to enter business contracts as stated in the main objects of the company as defined in the memorandum of association of the company and if the directors do enter contracts which fall outside the main objects of the company, then actions of the directors would

not bind the company and would be regarded as ultra vires [20, 18]. However, as per section 31 of the CA 2006, a company may have unrestricted main objects unless their article of association specifically, limits the objects of the company. Where a company enters into business contracts with a third party in good faith, the authority of the directors to bind the company or to permit others to act so is presently considered to be free from any restriction under the company's articles and memorandum of association. This indicates as long as the articles of a company does not restrict any object, specifically, the company is free to enter into a contract with the third parties on any main objects, which is not restrained by the articles of the company. Further, the directors are now empowered to approve any business transaction or can authorise others to do so, if such objects are not restrained by the articles of the company [2, 36].

The introduction of section 31(1) of the CA 2006 has resulted in "death of doctrine of ultra vires." Thus, this research article will analyse how section 31(1) of CA 2006 makes the doctrine of ultra vires as held in *Ashbury Railway Carriage and Iron Co Ltd v Riche* a redundant one and how this section will be applicable to charitable companies or companies not for profit by restricting their objects in articles in a depth manner.

Analysis of Doctrine of Ultra Vires in the background of CA 2006, section 31(1) of the CA 2006 offers a new approach to the issue of company's main objects. Section 31 of CA 2006 is unique in nature as the companies are not needed to state their main objects as they will have unrestricted objects unless its objects are explicitly restricted by its articles [1, 57]. This is clearly a retrograde step as compared to what was held in *Ashbury's* case. In *Ashbury's* case, it was held that every outsider who deals with the company should know what its objects are by going through its articles or memorandum of association. Without knowing this, if an outsider enters into a business deal with the company, and if it falls outside the main objects of the company, then such contract

will become ultra vires and directors, and even members cannot ratify the same later [8, 22]. This really connotes that until a company makes a purposeful option to limit its objects, the company can pursue whatever objects it wants to do. The main intention of the section 31(1) of CA 2006 is to make sure that companies enjoy liberty to engage in business dealings without any limitations or bar in the object clause. Thus, the section 31(1) of CA 2006 makes the doctrine of ultra vires a redundant [6, 36].

Further, section 39 of the CA 2006 states that any action that is embarked on by the company in its corporate capability will not be questioned despite whatever thing in its charter. The collective impact of section 31 and 39 of the CA 2006 connotes that there are restrictions to the company's goals or capacity in which it can conduct its business. In dealing with the third parties, in its commercial dealings, a company has complete independence and freedom. The brunt is that the operations of a company cannot be queried thereby dismantling the remaining of any external impacts of the doctrine of ultra vires [18, 251].

Nonetheless, under section 31 of CA 2006, some type of companies like charitable companies or some community interest oriented companies may elect to limit the extent of their main objects. Though under section 39 of the CA 2006, the company's action will not be called into a query despite the company's main goals, particularly, which restricted the ambit of a company's capability as detailed in the company's charter or in the articles, the internal impacts of the doctrine of ultra vires still rule. If a company peruses any restricted acts or objects, directors of the company will be still held responsible to the shareholders. This has also impact on the authority of directors of a company to peruse restricted objects or acts. Thus, section 31 of CA 2006 make sure that authority of directors will also be restricted or constrained from perusing into restricted objects or acts, as in such cases, the directors would have surpassed the company's capability. If the directors indulge in such restricted activities, they would be held responsible by

the shareholders for their deeds and actions as this would tantamount a contravention of their statutory duty of authority imposed on directors [18, 252].

After the introduction of section 31(1) of the CA 2006, the companies are not now required to express any objects in their charter. If the companies do express their main objects, then there will be some limit on their functioning or capacity. However, Community Interest Companies and Charities will still require state their objects, mainly to fulfil the legal requirements in this regard [18, 252].

Section 171 of CA 2006 deals with the duty of directors to function within their authority and if this section read along with the section 39 of the CA 2006, which has offered some additional legal safeguard where the company through its charter limits the authority of its board of directors, or if it has a definite object clause [18, 252]. It is to be noted that there is no mention about the rights of a shareholder of a company to stop an ultra vires action in advance which is not specifically mentioned in the CA 2006 [15, 42].

The CA 2006 has made a death knell to the doctrine of ultra vires. For example, as regards to a company's capacity, the section 39 of CA 2006 specifically states that the legality of an act perused by a company shall not be questioned on the footing of lack of authority by reason of anything in the company's charter. Thus, under CA 2006 of UK, the main objects of a company may be unlimited and where if any company has limited its objects, then the authority of directors of that company is also restricted accordingly. Further, as per section 171 of the CA 2006, a director has a specific duty to stick out with the company's charter. Further, section 40 of the CA 2006 offers protection to every third party engaging with a company with a good faith. It is to be noted that the authority of directors to permit others to bind the company or to bind the company is said to be limited by the company's charter. Thus, a third party who is engaging with a company in good faith need not worry itself about whether a company is performing within its charter or not [15, 42].

Thus, a third party who is dealing with a company is not required to find out whether there exist any restrictions on the authority of directors of a company. This is concerned with limitations in a company's charter that restrict a company's capacity to act and ultimately, the authority of the directors to obligate the company which is christened as the doctrine of ultra vires. However, under CA 2006, the object of a company is no longer impacts the company's capability to function [15, 40].

As per Sulkowski and Greenfield, the doctrine of ultra vires has traditionally facilitated a member of a company to initiate a legal action to bar a company from indulging in an act which falls outside of the exact boundaries of its company charter. Sulkowski and Greenfield's observation are also reflected in an immunity to a general rule in *Foss v Harbottle*, permitting for an individual member of a company to initiate a derivative action on behalf of the company to bar the company directors from indulging in ultra vires actions [15, 40].

In normal parlance, object clauses are broadly outlined so that acts are much likely to be less that can be considered as ultra vires or void. Each clause or paragraph in the objects' clause can contain a split and main object which can be perused separately of the others as laid down in 1918 in *Cotman v Brougham*. Due to this, fundamentally, a company can now be incorporated as simply as "a general commercial company [17, 42].

The directors may have surpassed their power despite the fact that the validity of an act perused cannot be called into question on the footing of lack of authority. It is to be observed that the section 40 of CA 2006 however states that if a person has dealt with the company in good faith, then the directors are bound by their action. To a far extent, we can say, that even if a company can be said to be responsible even if the third parties recognise that the envisaged business is ultra vires of the object clause of the company [14, 191]. Further, those companies registered immediately under CA 2006

after October 2009 will have no bar at all on their contractual capability, unless they select to restrict the same, if they want to have any restriction in their object, which should be ostensibly done in the Articles of Association of the company.

The term “General Commercial Company” was initiated through the CA 1989 which allowed the companies to peruse “any legal or lawful business or trade” [12, 239]. To counterbalance the difficulties caused by the doctrine of the ultra vires to third parties, the doctrine of ultra vires was abandoned effectively by CA 1989 by the inclusion of a new section 35 into the CA 1985. An activity of a company cannot be queried on the footing of a lack of corporate capacity under section 35(1) of the CA 1985 and hence where an act falls beyond company’s objects, it becomes effective and binding [16].

A sea change to the company’s constitution has been introduced by the CA 2006 as it is now prescribes a single constitution for incorporation of a company. Now, the significance to the memorandum of association of a company has been relegated, and it is now just a shorter document and requires the subscribers to state that they wish to incorporate a company, consent to be the members of that company and is prepared to subscribe at least one share each. Now, under CA 2006, the Articles of Association has become the company’s constitution [4].

As the memorandum of association of a company has already lost its significance under CA 2006, for the existing companies that were incorporated before 1 October 2009, which contains their main objects in their memorandum will now be automatically contained in its articles despite the fact that these may be amended or deleted by special resolution [5, 135].

As of 1 October 2009, a latest model form articles will substitute Table A as the default articles. For private and public companies, there will be separate forms of model articles. Now, companies in UK can follow either the model articles, peruse or alter them or neglect them or peruse bespoke articles for their use. Unless new articles are adopted, for existing companies, Table A in force at the time of its corporation will prolong to apply.

The introduction of the section 31 (1) of CA 2006 makes the doctrine of ultra vires a redundant. Now, section 31 of CA 2006 make sure that authority of directors will also be restricted or constrained from perusing into restricted objects or acts. Under CA 2006, the object of a company is no longer impacts the company’s capability to function. The CA 2006 Act has made a death knell to the doctrine of ultra vires. Further, both the CA 1989 and 2006 have made a considerable changes in the constitution of the company thereby making the doctrine of ultra vires a thing of past now.

References:

1. Andenas M. T., Andenas M., and Wooldridge F., *European Comparative Company Law* (Cambridge University Press, Cambridge 2009).
2. Birds J., Hildyard Q. C., and Hildyard R. *Annotated Companies Legislation* (Oxford University Press. Oxford 2010).
3. Bourne N. *Bourne on Company Law* (Taylor & Francis, London 2011).
4. Cahn Andreas and Donald D. C. *Comparative Company Law*. (Cambridge University Press, Cambridge 2010).
5. Calder *Corporate Governance: A Practical Guide to the Legal Frameworks* (Kogan Page Publishers 2008).
6. Emanuel S., and Emanuel L., *Corporations*. (Aspen Publishers, London 2009).
7. Goel P. K. *Business Law for Managers*, 2006–07 Ed. (Dreamtech Press, New York 2006).
8. Mars S. B., & Soulsby J., *Business Law* (Nelson Thornes, London 2002).

9. Mead L., Sagar D., & Bampton, CIMA Official Learning System: Fundamentals of Ethics, Corporate Governance. (Butterworth Heinemann, London 2009).
10. Mwenda K. K. Legal Aspects of Banking Regulation: Common Law Perspectives from Zambia (Pretoria University Law Press, Pretoria 2010).
11. Rush J. & Otley M., Business Law. (Cengage Learning, New York 2006).
12. Saharay H. K., Company Law (text book) (5th edition Universal Law Publishing, London 2008).
13. Sheikh S. A Guide to Companies Act. (Routledge Cavendish, London 2008).
14. Verlag Goyang Media Ltd, Companies Act 2006 (Verlag Goyang Media Ltd, London 2008).