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Chapter 16: Corporations

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CHAPTER 16

Corporations

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§16.1. Ultra vires. Two decisions 1 during the 1957 Survey year indicate that the ancient doctrine of ultra vires, often criticized as no longer fashionable 2 and generally believed to be of diminishing importance to practitioners, 3 still has considerable vitality.

Except in one or two limited areas there is a fair degree of unanimity among American courts 4 both as to what constitutes an ultra vires contract and what are the legal consequences arising from such an agreement. Thus it is almost universally held both in Massachusetts and elsewhere that an ultra vires contract which has been fully executed by both parties will be allowed to stand; 5 and, conversely, no rights arise under a wholly executory ultra vires agreement. 6 The partially executed contract, however, has proved to be a source of conflict not only among the several states but frequently decisions in the same jurisdiction are difficult to reconcile. Massachusetts 7 and a small number of other states 8 have generally followed what used to be called the "federal rule," a description rendered obsolete by Erie Railroad Co. v. Tompkins. 9 Since the "federal rule" was often referred to as

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2 Magruder, J., dissenting in Herbert v. Sullivan, 123 F.2d 477, 479 (1st Cir. 1941).

3 "The phrase 'ultra vires' . . . is of far less practical importance today. . . . In [present day] practice, the 'grant of powers' to the corporation consists of approving a corporate charter written by the attorneys for the incorporators; and the charter may include practically any powers and purposes which the incorporators or their counsel agree to write into their documents. . . . At all events, when a true question of 'ultra vires' is raised under a modern charter, it is generally a proof of poor draftsmanship on the part of the incorporating lawyers." Berle and Warren, Cases and Materials on the Law of Business Organization (Corporations) 45-46 (1948).

4 Stevens, Corporations 317 (2d ed. 1949).


8 Ballantine, Corporations §95 (rev. ed. 1946).

9 304 U.S. 64, 58 Sup. Ct. 817, 82 L. Ed. 1188 (1938).
the English doctrine, arising as it did from the influence of Directors of The Ashbury Railway Carriage & Iron Co. v. Riche, the latter description may be more useful.

Under this doctrine an ultra vires contract was regarded as void, so that no recovery on the contract was permitted even though the plaintiff had fully performed his obligations. To prevent unjust enrichment the court permitted the plaintiff to recover in quasi-contract to the extent that he could establish that the defendant had received the benefit of his performance. Quasi-contractual relief, however, was often inadequate since frequently, as in the typical ultra vires guaranty situation, the insolvent principal rather than the solvent guarantor was regarded as the recipient of the benefit of the creditor-plaintiff's performance. An extreme illustration of the inequity of the English rule is found in Herbert v. Sullivan, a First Circuit Court of Appeals decision construing Massachusetts law. In this case a corporation made an ultra vires loan to the executors of an estate who signed a note to evidence their debt. Suit on the note was dismissed on the ground that the corporation had no power to make such a loan. Thus ultra vires, frequently regarded as a shield to protect the corporation against acts beyond the charter powers, was used as a sword to prevent the corporation from recovering money actually lent, merely because authority for the loan could not be found in the corporate purposes. Trapped by its rigid adherence to what it regarded as controlling Massachusetts decisions, the court in a somewhat rueful dictum pointed out that quasi-contractual relief would also be denied, since the defendants had used the money to pay debts of the estate and hence had not benefited individually. Judge Magruder in a vigorous dissent protested against what he regarded as an unwarranted extension of the Massachusetts cases.

With such a result possible under the classic English rule, it is not surprising that the Supreme Judicial Court in its two current decisions was quick to find adequate grounds for rejecting ultra vires as a defense to liability. In Wiley & Foss, Inc. v. Saxony Theatres, Inc., the defendant's charter permitted it to operate, maintain and equip theaters. The plaintiff, a general contractor, which had previously done repairs on a theater owned by the defendant, was asked by one of the stockholder-officers to do similar work on another theater. The officer knew, but the plaintiff did not, that the second theater was owned by a different corporation, in which the officer also held stock. In defense of the plaintiff's action the defendant asserted that the contract was ultra vires since it involved work performed for another corporation and from which the defendant derived no benefit.

10 L.R. 7 H.L. 653 (1875).
12 249 Mass. at 603, 144 N.E. at 755.
13 123 F.2d 477 (1st Cir. 1941).
14 123 F.2d at 478.
15 123 F.2d at 479.
16 335 Mass. 257, 139 N.E.2d 400 (1957).
The Court in permitting recovery pointed out that this was not an instance of the exercise of power "manifestly outside the general authority granted by...[the] charter," but rather it was a situation in which the general corporate authority was abused in the particular case. Thus the corporation had the authority to operate and repair theaters; the fact that the theater in question was not owned by the defendant made the contract an abuse of the general corporate authority. And since the actual ownership of the theater was not known to the plaintiff, the defendant was not permitted to assert the defense of ultra vires.

In making this ruling the Court did not expressly rule that the contract was ultra vires, although it would appear that any corporate contract from which the corporation cannot possibly derive any benefit must fall into that classification. On that premise the decision represents an exception to the general rules referred to above with reference to ultra vires contracts fully performed by one party. Thus even in a jurisdiction which follows the English doctrine, recovery on the contract is permitted if the agreement falls within the general corporate purposes but is unauthorized solely because of an extrinsic fact (here the ownership of the theater) not known to the performing party.

The decision in the Wiley case, however, does not represent a sharp break with tradition. In fact the Court relied on the leading case of Monument National Bank v. Globe Works, decided almost ninety years ago, in which the defense of ultra vires was unsuccessfully interposed against a holder in due course of a promissory note. As in the Wiley case, the corporation had the general power to issue the note but an extrinsic fact unknown to the plaintiff (that the note was an accommodation instrument) made issuance of the note unauthorized in the particular case. Although the Monument National Bank case involved a negotiable instrument, the Court in Wiley readily extended the reasoning of the earlier decision to a situation involving an ordinary contract.

In the second ultra vires decision of the 1957 Survey year the Court had even less difficulty in rejecting the defense. Wasserman v. National Gypsum Co. involved a situation in which the Shanley Lumber Corporation had paid a debt owed by the Arey Company; the latter was one of Shanley's principal suppliers and was owned by the same stockholders. Upon the subsequent bankruptcy of Shanley its trustee in bankruptcy, asserting that the payment of Arey's debt was ultra vires, sued the creditor to recover the amount of the payment. In affirming a decision in favor of the defendant, the Supreme Judicial Court rested

17 335 Mass. at 261, 139 N.E.2d at 402.
18 101 Mass. 57 (1869).
19 A similar result was reached in Timberlake v. Supreme Commandery, United Order of the Golden Cross of the World, 208 Mass. 411, 94 N.E. 685 (1911), involving an allegedly ultra vires insurance contract. See also Ballantine, Corporations §97 (rev. ed. 1946).
its ruling on two principal grounds. First, the relationship between Shanley and Arey and the benefit to the former from the latter’s continued operations justified the payment as within Shanley’s corporate powers. Second, Arey had repaid Shanley for this advance, so that even if it had been an ultra vires expenditure, Shanley had been reimbursed and accordingly suffered no loss as a result of the payment.

§16.2. Stockholder’s right of inspection. Gavin v. Purdy, although by no means an unusual decision, serves as a reminder that a stockholder of a Massachusetts corporation has dual rights to examine corporate records and books of account. One right is a creature of statute; G.L., c. 155, §22 gives a stockholder a substantially unlimited right to inspect basic corporate organization papers, by-laws, records of stockholders’ meetings and stockholders’ lists. Books of account and other corporate records, however, are not covered by the statute. To inspect these the stockholder must rely on his rights under common law.

In the Gavin case the stockholder petitioned for a writ of mandamus to compel the clerk of the corporation to permit her to examine the list of stockholders and all the books and records of the company. Since the stockholders’ list was covered by the statute, the Court sustained a demurrer to the petition on the ground that the petitioner should have invoked the statutory remedy, a bill in equity seeking appropriate relief.

As to the other records, the petition indicated that the stockholder was primarily interested in certain allegedly improper payments of corporate funds. The demurrer was also sustained on the basis that the allegations were vague and indefinite and on the general ground that the petition was insufficient to warrant relief by mandamus.

The broad scope of examination sought by the stockholder (“all books and records of the corporation”) combined with the vagueness of her petition made the decision almost inevitable. The Court accordingly did not find it necessary to make an extensive review of the requirements for a successful mandamus petition to enforce the common law right of inspection. Instead it merely listed several familiar criteria: that the granting of relief is discretionary with the Court; that without such relief serious prejudice to the interests of the stockholder is likely to occur; that the stockholder’s purpose must be honest, not merely speculative or vexatious; and that the effect upon the corporation in reference to competitors and others is not to be disregarded. In brief, the Gavin case indicates a continuation of the Massachusetts doctrine that a stockholder who seeks to invoke his common law right of inspection must sustain a heavy burden of proof as to motive and purpose.2

§16.2. 1 335 Mass. 236, 139 N.E.2d 397 (1957).
2 Cf. Albee v. Lamson & Hubbard Corp., 320 Mass. 421, 69 N.E.2d 811 (1946), in which the Court stressed that the burden of proving good faith and a proper purpose must be sustained by the petitioning stockholder.