ABOLITION OF THE DOCTRINE OF ULTRA VIRES AND PROMOTION OF CORPORATE CONTRACTUAL FREEDOM: AN APPRAISAL OF LAW REFORMS IN SRI LANKA

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ABSTRACT

The doctrine of ultra vires in relation to company law was originally established by the judiciary to protect the company's shareholders and creditors by assuring them that their investment will be employed by the company only for known and declared business activities that were lawfully and expressly granted to it by the objects clause contained in the company's memorandum of association. This doctrine demarcated and defined the contractual capacity of a company and assured that company's funds will not be dissipated in unauthorized activities which shareholders and creditors did not have in contemplation at the time of investing their money in the company. However, the doctrine caused widespread confusion and created adverse effects and hardships for the company, its management and for persons dealing with the company as it severely and rigorously hindered the scope of a company and restricted the competency and the power of a company to make contracts. The Sri Lankan Companies Act No. 7 of 2007 effectively enables an incorporated company to engage in any lawful activity by seemingly extinguishing the longstanding doctrine of ultra vires. This paper is an effort to critically analyze and inquire into whether the doctrine still retains any relevance to the modern company law in Sri Lanka and whether its abolishment has served the purpose it sought out to achieve i.e. to strengthen the position of companies in terms of their capacities by giving them wider ambit and discretion to engage in business. It also investigate whether the Act expands the freedom of a company and grant it full capacity in order to reach its zenith or whether this paradigm has yet to become a reality. This is a qualitative research; mainly, carried out by reference to secondary data.

Keywords: ultra vires doctrine, commercial freedom, objects, legal personality

INTRODUCTION

The doctrine of ultra vires[1], a principle developed by the English common law in the nineteenth century, conferred the legal personality of a company only for the particular purpose/s referred to in an object clause stated in its memorandum. The simple meaning of ultra vires is 'beyond powers'.[2] In the context of company law the phrase ultra vires denotes the acts that fall outside or are beyond the powers conferred on the company by its constitutional documents.[3] In other words the doctrine, in company law refers 'to the principle that a contract entered into by a company in excess of its corporate capacity as defined in its Memorandum of Association (hereinafter referred to as MA), is invalid'.[4] This was a regulatory device sought to prevent registered companies from entering into transactions which exceeded the scope of the company's contractual capacity, contractual capacity being determined by the contents of the company's object clause.[5] The objects clause which is included in the company's constitution[6] elaborates the purposes and the activities a company is expected to carry on. Further, it narrows the powers and the scope of a company and if the company engages in any activity or enters into transactions beyond the powers given by the objects clause, such acts are deemed to be ultra vires and therefore void *ab initio*. Where a transaction is ultra vires and void in its inception, not even the unanimous consent of all shareholders would enable the ratification of the effect of the

[1] Hereinafter referred to as 'the doctrine'

[2] The term used to refer to acts taken by a corporation or officers of a corporation that are taken outside of the powers or authority granted to them by law or under the corporate charter. http://definitions.uslegal.com/u/ultravires/

[3] Originally companies were required to have two documents as Memorandum of Association and Articles of Association. The objects clause of the Memorandum of Association contained the object/s for which the company was formed.

[4] Cabral, H., (2007) *Companies Act No 7 of 2007 and the Corporate Law of Sri Lanka* at 25.

[5] Griffin. S., (1998) *The Rise and Fall of the Ultra Vires Rule in Corporate Law* 2 MJLS 5 at 1

[6] This can be either memorandum of association or articles of association depending on the requirement provided in the Companies Act.

transaction's invalidity. Since a company does not possess the legal capacity, as a general rule an ultra vires act cannot be enforced by or against the company as the company could not go beyond its objects clause.

OBJECTIVE OF THE RESEARCH

This research is an effort to critically analyze the historical development of the doctrine in English law, its application in the Sri Lankan context and apparent justification for doing away with the doctrine. It has also been analyzed whether the doctrine still retains any relevance to the modern company law and whether its abolishment, in fact, has served the purpose it sought out to achieve under the Companies Act No. 7 of 2007. Further the paper endeavors to examine whether the doing away of the doctrine in Sri Lankan law has brought about a concrete change in the system, letting companies be liberal in their decision making and granting companies complete contractual freedom and capacity.

PURPOSE OF THE DOCTRINE

As per common law, a company has the same legal capacity as a human being.[7] In order to protect the investors and creditors of the company, the doctrine was created and evolved by the court. It was first introduced in relation to statutory companies and the main purpose of the doctrine was the conservation of corporate capital against exploitation.[8]

Professor Gower referring to this doctrine has stated that:

"… it ensured that an investor in gold mining company did not find himself holding shares in a fried fish shop."[9]

With the favourable atmosphere created as a result of the doctrine of limited liability in 1855[10] and the growing importance of the MA, the doctrine was firmly established and applied in the strict sense in *Ashbury Railway Carriage and Iron Company v Riche*[11] where it was held that 'a company incorporated under the Companies Act has the power to do only those things which are authorized by its objects clause and anything not so authorized expressly or impliedly, is ultra vires the company and cannot be ratified even by the unanimous agreement of the members'. Later on, in the case of *A.G. v Great Eastern Railway Company*,[12] this doctrine was made clearer. However it was held that the doctrine 'ought to be reasonable, and not unreasonably understood and applied and whatever may fairly be regarded as incidental to, or consequential upon, those things which the legislature has authorized, ought not to be held, by judicial construction, to be *ultra vires.*[13]

As stated earlier, originally the legal rationale underpinning the object clause was to protect a company's shareholders and creditors by creating parameters within which the company is supposed to operate and not supposed to transcend or cross. The application of the doctrine to safeguard corporate capital can be justified as the company's shareholders agree to part with money on the faith that it shall be invested in the stated objects and in no others, and the creditors[14] giving credit to the company on the faith of the implied representation that the capital shall be applied only for the purposes of the business.[15] Therefore it would be unfair to allow the company to thereafter diversify, encompassing an activity of a wholly different nature, unanticipated by the shareholders and creditors.[16] Hence, it was expected in its inception, that the doctrine will act like a

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[7] Sutton's Hospital case (1612) 10 Co. Reports 23.

[8] Gower, L.C.B., *Gower's Principles of Modern Company Law* 5th Edition, Sweet & Maxwell, at 78. Particularly in the case of East Anglian Railways Co v Eastern Counties Railway Co (1851) 11 CB 775, in a case between statutory companies, and also Shrewsbury and Birmingham Railway Co v North-Western Railway Co (1857) 6 HL Cas 113.

[9] Supra at p. 165

[10] The concept of limited liability was introduced in relation to companies after the Industrial Revolution in 17th Century in order to raise capital for larger companies. The members of the company could avoid their personal liability for corporate debts and other liabilities due to this limited liability concept.

[11] (1857) LR 7 HL 653

[12] (1880) 5 App. Cas. 473

[13] Raghuvanshi, R. S., (2011) *Doctrine of Ultra Vires in Company Law*, at 5. Through diverse means, the English courts acted to curtail the severity of the doctrine, since the rule appeared to be having opposite result to what it was initially intended.

[14] It made an assurance to the creditors that the company funds to which they look for payment are not engaged in unauthorized activities – Million, D., (1990) *Theories of the Corporation,* Duke Law Journal, 201 at 218

[15] Singh, A., (1971) *In Defence of Ultra Vires*, 2 SCC (Jour) at 25

[16] Cotman v. Brougham (1918) AC 514

watch dog and safeguard the investors and creditors by ensuring that the capital of the company will not be diverted to objects not contemplated by them. This was to ensure that they would not suffer unnecessary losses at the hands of the company. Hence the doctrine drew a fine demarcation between what companies can do and cannot do as it provided a boundary line beyond which a company cannot go. Moreover it served the State's interest by allowing the government to keep the corporations within the bounds of a specific activity.[17]

Since its inception, the doctrine has been the point of contention between the courts[18] which were keen to limit companies' powers and, entrepreneurs[19] who successfully invented ways to circumvent them. As a result of the doctrine, the objects clause became very lengthy because companies included all the objects they could conceive in order to avoid the impact of the doctrine.[20] The use of independent object clauses where a statement was inserted to the effect that all the objects are independent and in no way ancillary or subordinate to one another[21] or the use of a wide object clause, showed that there had been attempts on the part of the companies to circumvent the restrictions placed by the doctrine. Therefore the original short form envisaged by the model memorandum in the company's regulations were rarely used.[22] Gradually, in the corporate world the doctrine was identified as meaningless as it was operating in an adverse manner. It became inevitable that the doctrine created hardships both for the management and outsiders dealing with the company and had proved to do more harm than good to them.[23]

It was evident that the doctrine had many inherent shortcomings, disadvantages and loopholes when it came to the capacity of the company as well as the rights of the third parties. The doctrine confines a company within fixed limits and hence the company cannot change its business, even when the business is not profitable and when it is apparent that some other venture is more suitable and profitable. This situation was more unfair as the company was unable to vary its activities even with the unanimous agreement of all relevant parties. This hindered the economic growth and development of the business.

The primary purpose of a company is profit maximization. In order to achieve the profit generating goals companies should have the discretion to act liberally. The effect of the removal of the doctrine can be said to offer the companies a wider ambit for its operation. In this context, the statement of Lord Devlin in the case of *Kum v Tat Bank Ltd*[24] is particularly appropriate:

> "The function of the commercial law is to allow, so far as it can, commercial men to do business in the way they want to do it and not to require them to stick to forms that they may think to be outmoded."

This serious concern was addressed in both the Cohen Committee and the Jenkins Committee and discouraged the application of the doctrine and recommended its abolition as it restricted the full contractual capacity of a company. Furthermore, statutory amendments also helped to lessen the application of the doctrine. Particularly, the section 9 (1) of the European Communities Act 1972, provided in favour of a person dealing with the company in good faith by stating that any transaction decided upon by the directors was deemed to be within the capacity of the company and provided protection for the third parties acting in good faith, giving them the ability to enforce the ultra vires transactions against the company. However, this section proved to be defective in several areas as it did not protect the company.

The latter part of the 19th century witnessed an economic and financial liberation, shifting away from a controlled economy to a laissez faire economy. Accordingly, many common law jurisdictions saw an evasion of the object clause. With the rapid growth of the economy, the shareholders started to pay less attention to specific lines of business the directors took a company into, as long as those businesses generated healthy profits which were necessary to pay a healthy dividend and assisted in raising the share value.[25] In view of the current economic, financial and social climate the doctrine was found way too rigid as the

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[17] Marsoof S., (2011) *The demise of Ultra Virus and the Protection of stake holders under the Companies Act of 2007* The Bar Association Law Journal Vol XVII, pages 1- 10.
[18] Courts wished to confine the object clause to short statements of the company's activities in order to reduce the degree of risks incurred by the shareholders and creditors, by virtue of adopting multiple objectives.
[19] They found themselves severely restricted in terms of freely pursuing lucrative business opportunities.
[20] Supra 16
[21] The use of an independent object clause was highly criticized in the Cotman v. Brougham Clauses case. Further it was followed in cases of Bell House Ltd. v City Wall Properties Ltd. (1965) 8 WLR 1323 and Re Introductions Ltd. (1970) Ch 199.
[22] Morse Geoffrey, (1991) *Charlesworth & Morse: Company Law*, at 70 Sweet & Maxwell Ltd., 14th Edition
[23] Anglo-Overseas Agencies Ltd v Green [1960] A11 ER 244.
[24] 1971 1 Lloyd's Report 444.
[25] Vaidya, N. and Raghuvanshi, R. S., (2010) Applicability of Doctrine of Ultra Vires on Companies http://papers.ssrn.com/sol3/papers.cfm?abstractid=1558971

company would stagnate in one place before the drastic changes in the modern corporate world which curtails the growth of the company.

Many countries after realizing the strenuous restrictions placed on the companies by the doctrine, decided that companies should be given the freedom and capacity to engage in activities not stated in the objects in their memoranda.[26] While Canada abolished the doctrine by way of section 15 of the Canada Business Corporation Act 1985, New Zealand did away with the requirement of a Memorandum of Association and an object clause by the introduction of section 8 of the New Zealand Companies Act 1993. However, even though s. 35 of the English Companies Act 1985 substantially changed the power of a company to alter its objects by a special resolution, the doctrine of *ultra vires* was not completely abolished from the English Law. Later the Prentice Report (1986) led to the Companies Act 1989 and recommendations were made to abolish the constructive notice but retain the doctrine. Finally, the significance of the doctrine in the English company law was weakened to a greater extent with the enactment of the UK Companies Act of 2006. Presently in English law, in terms of s. 31(1) of the 2006 Act, having an object clause is not a mandatory requirement for a company. The fact that most of the countries have partially or completely done away with the doctrine, proves that it has fallen into disuse.

ULTRA VIRES DOCTRINE IN SRI LANKAN LAW

Prior to legislative reforms, the doctrine manifested in the company law of Sri Lanka in the form of the object clause contained within the memorandum and restrained itself to pursuing those objects which were deemed as a mandatory prerequisite for the incorporation of a company. In Sri Lanka, S. 3 (1) (c) of the Companies Act No 17 of 1982 (1982 Act), made it mandatory to list the objects of the company in its Memorandum of Association. This is merely an adoption of the English law and similarly the rationale behind this was to narrow down the main purpose of the company which would give a definite idea to the investors as to what type of business would be carried out by the company. Further, s.4 of the 1982 Act went beyond its English counterpart[27] and categorized the objects as primary objects[28] and objects other than the primary objects. S. 7 of the 1982 Act provided a mechanism to alter the objects with severe restrictions. In the case of Jupitar Cigarette & Tobacco Co. Ltd v Soysa[29] where the issue was the number of directors who signed the bond happened to be less than the number required by the articles of the company, the Privy Council first recognized that the doctrine was a part within the framework of Sri Lankan law. However, the restrictions that were placed tendered to be quite rigorous and the law reformers of Sri Lanka were of the firm view that the doctrine should be done away with.[30]

With the development of international commerce and industrialization, countries all over the world including in Sri Lanka, following the opening of the economy, in order to meet the policy expectations, the corporate world needed an effective and responsive regime of company regulation. The unprecedented growth in economic activities in the nineties created a pressure on companies to devise efficient financing techniques to raise capital. The entrepreneurs were more interested to move freely in various fields of business. Therefor the rigid concepts like doctrine of *ultra vires* did not suit these free thinkers who wished for a wider ground to play and greater discretionary powers to carry out their innovative projects. Accordingly, Sri Lanka deviated from the English Law and embraced the progressive elements of company law found in Canada and New Zealand and gave birth to the Companies Act No. 7 of 2007 (the Act) addressing the new and unique trends of the Sri Lankan business world.

CHANGES INTRODUCED BY THE ACT

The Act was enacted marking a significant milestone in the development of company law in Sri Lanka which shaped up new reforms in order to embrace new realities. The Act consolidated all the previous laws which regulated the corporate field and cleared ambiguities introducing several crucial conceptual changes. One of the major changes introduced by the Act was the removal of the doctrine of ultra vires. The Act has dispensed with *inter alia,* the requirement of memorandum and object clause, thereby granting the company the capacity to undertake any lawful business or activity or do any act or enter into any transaction and diversify away from its original business. Therefore the removal of the objects clause along with the memorandum is seen as simplification of the incorporation process as well as removal of the rigour imposed by the doctrine.

[26] Recognizing the economic realities, a significant number of common law jurisdictions, including New Zealand, Canada, Hong Kong and Australia have taken drastic changes in the application of the doctrine.
[27] English Companies Act of 1948
[28] The objects which intends to carry out during the first five years of its commencement of business.
[29] (1971) 74 NLR 241 (PC)
[30] Supra 4 at 27

The Act attempts to lessen the extremity of the doctrine by giving a company the commercial freedom of a natural person. It recognizes that a company has unrestricted capacity and powers to enter into commercial activities unless otherwise stated under the Articles of Association, which is now the sole constitutional document of a company.

As aforementioned, the s. 4 of the Act does away with the requirement of a memorandum and accordingly, the company needs only to submit Articles of Association at the time of incorporation and thereby dispenses with the ultra vires doctrine [31]. This has widened the scope of the activities a company can engage in and thus enables the expansion of its business. Accordingly, the author observes that the current requirement of companies having only to submit Articles of Association is an indication of the contractual freedom enjoyed given the ultra vires doctrine is dispensed with, to a certain extent. However, even if the Act removed the mandatory requirement of having an objects clause, any company may specify its objects in its articles if it wishes to do so[32]. Under s. 17 (1) of the Act, if the objects of the company are included in the articles, there shall be deemed to be a restriction placed by the articles in carrying on any business or activity that is not within the objects so stated, unless the articles provide otherwise. S. 17(2) ensures that the capacity and powers of the company are not affected by the restriction placed by the articles, ensuring much protection for the third parties. This perceptibly reduces the risks faced by the third parties when dealing with corporate enterprises, which is likely to boost their confidence in companies.

However, although such objects are deemed unrestrictive, they are not completely ineffective. Such restriction has an internal effect and therefore a shareholder or a director may obtain a restraining order against the company from acting inconsistently with such restrictions, unless the company has contracted or entered into obligations to do so. In other words shareholders have the power to go before courts to restrain the company from carrying out any business outside its stated objects if they feel that a particular business is likely to cause losses. If the contract is already entered into, shareholders can claim damages from the directors for their losses.[33] In addition to this, directors remains personally liable for the contravention of the articles. In the light of this observation, one can claim that the abolishment of the strict application of the doctrine of *ultra vires* by S.17(2) now provides the ability for companies to widen their ambit of operations, given the unrestrictive nature of object clauses (though, as pointed out they can be also be used to hold those steering the company liable).Therefore one can argue that Sri Lanka has promulgated laws which are supportive of widening the contractual capacity of companies by restricting the impact of the doctrine of *ultra vires*. It is right to say that the full contractual capacity of a company as a legal person is enshrined in the Act.

In the context of the above analysis it is important to further assess the impact of the restriction of the effect of the doctrine on Sri Lankan company law. The removal of the doctrine, in terms of Sri Lankan law, has given companies the capacity of a natural person, and has eliminated the unfairness brought in by the doctrine. It has indeed strengthened the company's capacity, since the companies are now afforded more maneuverability, without the restrictions placed by the company's constitution. Further, the companies are now prevented from using the doctrine to shy away from the responsibilities against third parties. It has therefore given greater discretion for the companies to decide on avenues and ventures that would bring in more profit and has simultaneously aptly ensured, by way of additional safeguards, that the shareholders and creditors are protected. The provision of having an objects clause in the articles if needed has provided an additional safeguard, along with such safeguards as minority exit options[34], major transactions, solvency test etc.[35]

It is therefore evident that though found to be a protective measure initially, as a result of the changes in the modern company law, the doctrine has proven to be more of a hindrance than a protection. The removal of the doctrine by the Act has resulted in the strengthening of the capacity of the company by giving it the status of a natural person. This encourages the companies to maneuver into different avenues of investment and make business decision with greater discretion and much freedom to adopt new objects in line with the changing economic environment. Therefore, the connection between the inclination of the legislature towards dispensation with the ultra vires doctrine and promotion of contractual freedom of a company is quite apparent.

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[31] S.4(1) (b)

[32] S. 13 (a)

[33] S. 233 gives the ability for shareholders and other stakeholders to apply to court to prevent company from acting contrary to restrictions contain in articles.

[34] Shareholders who rejects a resolution to alter the articles of a company which changes a company's permissible business activities or approves a major transaction may require the company to buy his/her shares - s. 93 of the Act. This allows the majority shareholders to decide on changes to business activities while still allowing minority shareholders the freedom to exit the company if they disapproves of these changes.

[35] Supra 4 at p. 27.

In order to better comprehend the effect of the total abolishment of the doctrine of ultra vires, the author believes it's beneficial to consider the impact of an example of another doctrine which operates no longer.

The doctrine of constructive notice strengthened the position of the doctrine of *ultra vires*. It placed unreasonable and unnecessary costs on businesses by requiring those who engage in transactions to examine the constitutional documents of companies in order to ascertain whether the company is authorized to engage in the particular transaction, has been abolished by the Act. S. 22 of the Act provides protection to persons dealing with the company by specifying that they are not required to inquire into the capacity of the company or authority of its directors by referring to the documents of a company which are available for the public. Notwithstanding this, a company would be bound by its action and therefore, a third party bears no mandatory duty to inquire into the capacity of a company or the authority of the directors to bind the company. Since the memorandum and the articles were public documents available for inspection, the doctrine of constructive notice had the effect of imputing the notice of the content of the company's constitution on persons who dealt with the company.[36]

This requirement created a gap between the legal theory and practice and was inconvenient as well as disruptive to the normal business practice. In reality, the business world is fast-paced. Everyone attempts to grab opportunities as fast as they can which hints the importance of time, especially in commercial dealings. Hence the doctrine of constructive notice proved to be an absurdity which created a sense of insecurity for third parties who entered into transactions with the company. The abolition of the constructive notice on the other hand has made business activities easier, because the parties dealing with companies need not read and understand the objects of the company before they enter into contracts. The objects stated by the company can sometimes be ambiguous or absurd. In such a situation whether a particular transaction falls within such objects can purely be a matter of interpretation. Nevertheless, the interpretation by outsiders, the company and the court can be different to each other. Hence the abolition of the doctrine of constructive notice has enabled the third parties to transact with companies without doubt.

In consideration of the positive effect on the contractual capacity of the company which resulted from the abolishment of constructive notice, one can conclude that the development of law has been beneficial to all stakeholder involved in the business of a company. It is with this insight the author further asserts that in the context of the doctrine of ultra vires, a similar effect is observable. This is buttressed by the appraisal of the laws underpinning it, as well as case law and related literature.

As discussed earlier the doctrine has less importance in company law in the present context although the Act does not completely eradicate its presence or extinguish the operation of the doctrine. While its external consequences in relation to creditors and third parties have been nullified, it is still possible to invoke the doctrine as an internal mechanism to ensure that the company and its directors do not act dishonestly[37]. S. 17 (3) of the Act encompasses the internal applicability of the doctrine. The shareholders or directors may obtain a restraining order against the company to prevent it from acting inconsistently with the stated objects unless the company has contracted or entered into a binding obligation to do so. Moreover the directors will also be personally liable for acting in contravention of the articles in the light of s. 188 of the Act[38]. As such, the outsiders are not affected by any transaction. The fact that outsiders are not affected by any transaction as a result of the doctrine's impact being toned down is an important point. This is evidence of the contractual freedom enjoyed by stakeholders of a company. That is to say, the legal provisions found which restrict the operation of the doctrine has provided companies and stakeholders with wider contractual capacity. Equally it also shows the limitations on the restriction on the application of the doctrine, and the further need for law reform for complete freedom of contractual capacity which the abolishment of the doctrine could achieve.

Furthermore, the doctrine is still relevant in regulating companies limited by guarantee. S. 33 (1) (a) of the Act stipulates that a company limited by guarantee must have articles which include objects of the company. In addition, S. 37 (1) of the Act read with the Part 1 to fourth schedule, provides for the matters to be specified by a public company in its prospectus and mandates the prospectus to specify the business which the company is to carry out during the period of 5 years from the date of commencement of the business upon issuance of shares to the public. Moreover, the Act firmly states that in terms of S.185 of the Act[39]which defines a major transaction, a company cannot substantially alter the nature of its business carried on by the

[36] Royal British Bank vs Turquand (1856)6 E & B 327

[37] Company directors owe a duty to act within the company's powers. S. 17 (3) (b) read with S. 188 of the Act.

[38] Section 188 specifies that it is a duty of every director of a company not to act in a manner that contravenes any provisions of the Act or the provisions in the Articles of the company.

[39] Section 185(1) specifies that a company shall not enter into any major transactions unless such transaction which the Company is expressly authorized to enter into by a provision in its articles which was included in it at the time the Company was incorporated. Section 185(2) defines a 'major transaction' to mean, inter alia, "a

company unless approved by a special resolution of the shareholders which as per s.143 of the Act requires a majority of 75% of those entitled to vote. Therefore, as per this provision too, it is clear that the doctrine is not altogether abolished.

Further, in the current context, companies choose to specify their objects in the articles with the aim of obtaining tax reliefs in terms of the Inland Revenue Act[40] or to get the approval from the Board of Investment[41] or in order to seek any other reliefs. As a result, the once held argument that companies are compelled to limit themselves to particular objects and if they act in excess of these they will be considered as acting ultra vires has not completely lost its significance in modern company law. Hence, although the doctrine no longer plays a central role in relation to the contractual capacity of a company, it is still significant in certain aspects of modern company law. This indicates that the Sri Lankan company law has not fully discarded the doctrine as there still are shades of the doctrine evident in the Act. Therefore, in the light of the research question one can claim that Sri Lankan law in the context of the 2007 Act has not completely diverted away from the doctrine, hence to a certain extent has had limitations cast on the contractual capacity of companies.

EFFECT OF THE CHANGES

The above discussed statutory provisions introduced remarkable changes to the company law in the country. Recently, the Supreme Court of Sri Lanka in the case of People's Bank v Yashodha Holdings (Pvt) Ltd[42] bid the final farewell to the ultra-vires doctrine. The rigorous application of the doctrine was challenged under the Companies Act of 1982. But the decision was given after the promulgation of the 2007 Act, where the Sri Lankan judiciary promoted the deviation from the doctrine due to the difficulties which have resulted. The court decision could be interpreted as a crucial step towards completely promoting contractual freedom in Sri Lanka.

The modern companies have been given the capacity of a natural person and they are allowed to perform any lawful act. The radical changes introduced by the new Act have eliminated the unfairness and uncertainty which were resulted by the doctrine. It is deemed that the removal of the doctrine will have the salutary effect of encouraging and promoting the formation of companies. Modern businesses are also allowed to amend their objects clauses easily and thereby allowing themselves to venture into new areas of business without facing any obstacles. Entrepreneurs also possess much freedom in the commercial world as a result of the relaxed approach.

Under the new Act, inclusion of an objects clause has no effect on the third parties or the contractual capacity and powers of the company. It does not render any act, contract or other obligation entered into by it, or any transfer of property invalid. The effect of s. 17 (2) of the Act is to confine the doctrine of ultra-vires to the internal management of a company whilst saving the actions and contracts of companies from invalidity. The third parties are no longer required to enquire into the capacity of the company or its director's authority before entering into transactions since the company is anyway bound by its actions. Abolition of the constructive notice improved the position of the outsiders dealing with companies. The external effect of the doctrine has been entirely done away with by the new statutory provisions of the Act. Moreover, the provision of the Act holding the directors liable in case of contravention of the objects clause is important in protecting shareholders' interests, since it ensures that investments are not misused.

As discussed above, the possible adverse effect of the abolition of the doctrine are off- set by the provisions included in the 2007 Act and provides for checks and balances to prevent the abuse of freedom in order to strengthen the rights of shareholders and other stakeholders of the company. The duties and responsibilities of directors are clearly spelt out and effective range of rights, such as derivative actions[43], restraining orders are made available for shareholders enabling them to enforce their

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transaction or service of transaction which have the purpose or effect of substantially altering the nature of the business carried on by the Company."

[40] Inland Revenue Act, No 10 of 2006 of Sri Lanka offer tax relief to companies in particular industrial and machine tool manufacturing, machinery manufacturing, electronics, export of non-traditional products, or information technology and allied services etc. In some instances the rate of tax applicable based on the objectives of the company. For instance Taxation for insurance companies – s. 92 of Inland Revenue Act, No 10 of 2006.

[41] Under the Board of Investment of Sri Lankan Law, No 4 of 1978, approvals and corresponding incentives are granted on the basis that companies will engage in specific projects. Hence, the BOI insists on an object clause for that purpose. Authorities that provide licenses to banks, leasing companies and broking firms also require an objects clause as part of their licensing conditions. Wickramanayake A. R., Company law in Sri Lanka (2007) at p. 60.

[42] SC CHC Appeal 21/06 SC HC LA 27/06 HC Civil 75/99 (1)

[43] S. 234

rights[44]. The limitations imposed on directors are justifiable as these provide checks and controls over the management of the company. If companies are allowed over freedom and greater discretion, the risk of susceptible risks cannot be avoided. Although such freedom and discretion is essential in the modern economy it may carry negative results to the detriment of company stakeholders instead of the success expected. The measures thus enumerated in the Act provide the legal backdrop for the effective promotion of contractual freedom of a company in the absence of the doctrine of ultra vires, as envisaged in the research question.

In addition, to ensure shareholder protection, Institute of Chartered Accountants in Sri Lanka has formulated ('ICASL') a Code of Corporate Governance in 1997, based on which the Securities and Exchange Commission of Sri Lanka proclaimed the Rules on Corporate Governance for Listed Companies which became mandatory on listed companies in 2008. The Securities and Exchange Commission of Sri Lanka (SEC) and the ICASL once again revised the Code of Best Practice in the year 2013. A code of Best practice on corporate governance is effective and compliance with its rule is mandatory for the effective protection of stakeholders and adequate discharge of the social responsibilities of company directors. These are additional measures undertaken by authorities to guarantee that stakeholders of a company are assured contractual freedom devoid of malpractices and other adverse effects, as a result of parting from the doctrine.

In Sri Lanka following the opening of the economy, the growth of trade and commerce often carries very high capital investment requirements. Due to the unprecedented growth in economic activities, a pressure was created on companies to devise efficient financing techniques to raise capital. In order to attract more and more investors and creditors the corporate world needed an effective and responsive regime of company regulation. The company must ensure that what so ever happened they are paid back with the benefits (profits for investors and interests for creditors) they entitled for. In the absence of the application of the doctrine third parties are ensured that companies cannot deny their obligation under any circumstances. Third parties can enter into transactions with companies without sparing time on reading lengthy object clauses to verify the capacity of the company or the authority of directors.

However, under the modern law, although companies enjoy a greater capacity, there is less assurance towards shareholders as to how and for what ends their investments will be used. Recent examples of such situations are the *Golden Key Credit Card Company* incident[45] and *Touchwood Investments Plc* crisis. The wrongful application of the company's assets and wrongful diversification of decisions may results in losses and insolvency of the company at the end. Therefore, the legal and regulatory mechanisms governing the functions and affairs of companies should be in place as a check on its liberalized capacity for assuring the optimum use of the investments of the company. This area can be cited as a lacuna which needs legal attention. The objective of dispensing with the doctrine of ultra vires is, as envisaged in the research question, promotion of contractual capacity of a company. However, in the process it is essential that the third party rights are adequately protected. Hence the assertion that there's need for more legislation addressing this area.

CONCLUSION

The object of the research has been to analyze if the current legal provisions in Sri Lanka related to company law have abolished the doctrine of ultra vires and the extent to which corporate contractual freedom has been achieved.

The author has initially analyzed the doctrine of ultra vires and its impact on the corporate world in the light of the case law and by reference to other jurisdictions in the world. Based on the initial discussion of facts the author concludes that the doctrine of ultra vires no longer serves its original purpose of protecting shareholders and creditors by assuring that the company assets will only be used to achieve the purpose/s specified in the objects clause. The protection it intended to offer was rendered superfluous and the drawbacks and non-suitability of the doctrine became apparent for it created more complexities, confusions, hardships and commercial constraints. The doctrine was way too rigid for a company as the company would stagnate in one place before the drastic changes of the modern corporate world and thus curtailed the growth of the company. Hence the abolition of the doctrine became a common practice across the globe. Measures taken in countries such New Zealand, Canada and England which have also been discussed in the research are evidence of this assertion.

Further, eliminating the memorandum and the object clause has simplified the incorporation process, reduced the cost of incorporation and the commercial constrains on business entities enabling commercial ventures to endeavor to obtain the

[44] Ss 224-232 of the Act improve the procedure available for making shareholder complaints against oppression and mismanagement

[45] The collapse of Golden Key Credit Company almost brought down Seylan Bank PLC a listed commercial bank and the State had to intervene to bail out Seylan Bank out of fear that the collapse of Seylan Bank would undermine the entire banking system in Sri Lanka and would have been catastrophic.

benefits of incorporation. The doctrine applied prejudicially paving way to inflexibility in corporate transactions which prevented companies from changing its activities to follow more lucrative trades if the opportunity so arose. The evolution from strict application of the doctrine to complete abolishment have been discussed with reference to case law as well.

The research objectives involved assessing the extent to which the doctrine of ultra vires was abolished by the legal framework in Sri Lanka, resulting in promotion of the contractual capacity of companies. Several observations have been made with respect to the research questions.

It is clear that the Act is remarkable in the development of company law in Sri Lanka. Whilst the initial stance was that of rigid application of the doctrine, the aftermath of the Act brought about significant change. The Act has changed the modern law relating to the doctrine, in comparison to the original position articulated in the case of *Ashbury* and given the company the capacity of a natural person, and has eliminated the unfairness brought in by the doctrine. In spite of the more expanded contractual capacity that resulted as a result of the promulgation of the Act, above analysis reveals that the doctrine has not completely lost its significance in company law since the 2007 Act has not completely eradicated its presence. It has managed to keep intact its internal effects within the company, which have manifested largely in mechanisms for strengthening and protecting stakeholder rights. Nevertheless, it has also been observed in this research that, more legal infrastructure is necessary to effectively ensure that all stakeholders involved in corporate contracts benefit equally.

Therefore, referring to the discussion of changes brought about by the Act and other legal mechanisms involved, it has been observed that in the Sri Lankan context the modern companies now possess much more freedom, capacity and discretion to engage in diverse business activities that would bring in more profit, as the doctrine has been considerably relaxed.

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