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APPLICABILITY OF THE DOCTRINE OF *ULTRA VIRES* ON PRIVATE COMMERCIAL COMPANIES IN ETHIOPIA: ITS LEGAL SIGNIFICANCE

BY: WONDEWOSEN EWUNIE DESALE

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Declaration

I, the undersigned, hereby declare that this thesis is my original work and has never been presented for a degree in any other university. To the best of my knowledge and belief, I also declare that all sources of materials used in the thesis have been dully acknowledged.

Declared By:

Name: Wondewosen Ewunie Desale

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Date: _____

Confirmed By:

Name: Zekarias keneaa (Associate professor)

Signature: _____

Date: _____

Dedication

To my mother, Mulu Ayalew, who has suffered much in nurturing me and is always solicitude of her son’s success and to my stepmother, Ayal Demberu, who thought me the wisdom of patience and devoted a lot to see me educated and succeeded.

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Abstract

The principle of limited liability introduced into private companies makes it imperative to define the powers and capacity of such companies, authority of their agents and the consequences and effects of ultra vires acts. The doctrine of ultra vires applicable to private companies was the invention of the judiciary which, subsequently, has been introduced in the commercial regime of both civil and common law jurisdictions, but not in every country. In this thesis, it is argued that the commercial regime of Ethiopia has given recognition to the applicability of the doctrine of ultra vires to private commercial companies, though not comprehensively. It is incomprehensive because the legal consequences and effects of ultra vires acts of private commercial companies are indeterminate. Moreover, the commercial regime of Ethiopia is impugned for it lacks clarity and specificity in regulating the consequences of acts ultra vires to company directors and managers and their liabilities.

Contents

Abbreviations

Art.	Article
Arts.	Articles
CC	Civil Code of Ethiopia
Com. Code	Commercial Code of Ethiopia
MoCI	Ministry of Commerce and Industry
MoTI	Ministry of Trade and Industry
PLC/s	Private Limited Company/Companies
SC/s	Share Company/Companies

CHAPTER ONE

1. Introduction

1.1. Background of the Study

Companies are formed with defined objects under their constitution- composed of Memorandum of Association and Articles of Association.[1] The companies' objects define the extent of capacity and power conferred on them.[2] Incorporated companies can undertake only those acts which their constitution "empowers [them] to do, or which are incidental to or consequential on the achievement of [their] express objects or the exercise of [their] express powers."[3] This statutory limit prohibits companies from exceeding the scope of their capacity and power and "company agents from exceeding their authority on transactions the company is not empowered or authorized to undertake."[4] Any act of companies and their agents beyond the statutory purposes or powers and capacity is to be declared *ultra vires*.[5] The concept of *ultra vires* in the context of companies denotes acting beyond the legal capacity, theorizing that a company which acquires legal personality by virtue of its incorporation cannot do business outside the purpose stated in its constitution.[6] It applies to companies in situations "where the company purports to act beyond its business purposes as set out in its constitution, [or] in a way prohibited by statute [and] where the company purports to act through the agency of someone who lacks the requisite authority."[7] Thus, *ultra vires* could occur due to lack of capacity- "when the company lacks the power on its own to act because it is outside its object clause," or owing to lack of authority- "when the officers of the company who act within the object of the company but without authority to do so"

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[1]Mark Stamp, *Private Company Law*, (3rd Ed, Cavendish Publishing Limited 2001) 35

[2]Olong Matthew (PhD) and Professor Richard (PhD), 'Trends in the Concept of Ultra Vires: The Nigerian Rethink' (2015) 3(3) Global Journal of Politics and Law Research 121

[3]Harry Rajak, 'Judicial Control: Corporations and the Decline of Ultra Vires' (1995) 26Cambrian Law Review10

[4]Aderonke Abimbola, 'A Legal Excursion into the Consequences and Effects of the Doctrine of Ultra Vires in Nigerian Corporate Governance' (2017) 65 Journal of Law, Policy and Globalization 222

[5]Michael A., 'Ultra Vires - Ultra Useless: The Myth of State Interest in Ultra Vires Acts of Business Corporations' (1983) 9 Journal of Corporation Law 81

[6]Wellalage Indira, 'Abolition of the Doctrine of Ultra Vires and Promotion of Corporate Contractual Freedom: An Appraisal of Law Reforms in Sri Lanka' (2017) 14(4) SEAJBEL 36

[7]Harry Rajak, (n3), p. 9

while the legal consequences that flow from each scenario varies.[8] Thus, an act beyond the objects of the company is to be declared null and void thereby cannot be ratified while an act *intra* to the business purpose of the company but *ultra* to the authority of directors and managers may be ratified.[9]

The doctrine of *ultra vires* was laid down, by the House of Lords in Ashbury Railway Carriage and Iron Company vs. Riche[10], to protect investors through enabling them know the objects for which their money is employed, and creditors through ensuring the conservation of company capital against exploitation through channeling it in unauthorized activity.[11] After that, it has evolved through court decisions[12] and company acts of different countries although it has been severely criticized, lately, for its strict application caused serious injustices as *ultra vires* act of companies were made null and void.[13]

In Ethiopia, formation of companies- share companies and private limited companies (hereinafter SCs and PLCs respectively, interchangeably, private commercial companies) are required to be made through public memorandum which shall contain, *inter alia*, the company's object i.e. business purpose.[14] Moreover, the objects of a company defined in its memoranda is to be registered and deposited in the commercial register for third parties to know the purpose for which the company is formed, and can't be varied until changed through amendment of the memoranda in compliance with prescribed procedures. The companies' powers and capacity is confined to the business purpose defined under its memoranda. This statutory limit prohibits companies from exceeding their powers and directors and managers from "exceeding their

[8]Olong Matthew (PhD) and Professor Richard (PhD), (n 2), p. 122

[9]Ibid, (*emphasis added*)

[10]Ashbury Railway Carriage and Iron Company vs. Riche [1857] LR 7 HL 653

[11]Ovunda V. C. Okene, 'Ultra Vires Doctrine in Company Law: Truly Beaten, But Not Dead' (2000) 4 Journal of Commercial, Private and Property Law 30

[12]The doctrine of ultra vires was also recognized in Indian in the cases of Jahangir R. Mod i vs. Shamji Ladha, ((1868) 4 Bom. HCR 185), and A. Lakshmanaswami vs. Life Insurance Corporation of India ((1963) 1 SCJ 521)

[13]Jack Anderson, 'The Evolution of the "Ultra Vires" Rule in Irish Company Law' (2003) 38 Irish Jurist New Series 263

[14]Commercial Code of the Empire of Ethiopia, Proclamation No. 166, 1960, *Neg. Gaz.* Year 19, No. 3, Arts. 313/4, 517/c (hereinafter the Com. Code)

authority on transactions the company is not empowered or authorized to undertake."[15] So, any act of the company beyond its objects and directors' and managers' acts beyond their authority, despite the acts themselves are within the objects of the company, should be declared *ultra vires*.

However, whilst the requirement of including objects clause of a company in the law is meant to define the extent of power conferred on it and thereby restricts its contractual and transactional power, the fate of *ultra vires* contracts and transactions entered into in default of complying with such restrictions is not clearly defined. Such absence of clear provision regulating the fate of companies' *ultra vires* acts accompanied with some clarity issues in the liability of directors and managers left the fate of *ultra vires* contracts and transactions indeterminate. Besides, it is not adequately clear as to whether the doctrine of *ultra vires* is introduced in its complete sense. Yet, while directors of SCs and managers of PLCs are deemed agents of respective companies[16], it is unclear the extent to which the law of agency is applicable, particularly, to determine the fate of *ultra vires* undertakings. So, possibly endangered interests of shareholders, creditors and third parties in the face of *ultra vires* acts of companies and their directors and managers are, as yet, contentious legal issues that require due attention.

The purpose of this research is, therefore, to identify the Com. Code provisions and other related laws meant to regulate the objects clause of private commercial companies and acts *ultra* to their objects. The research also tries to analyze the CC[17] provisions on the law of agency to elucidate possible consequences of *ultra vires* acts of companies and their directors and managers and their implications on stakeholders.

1.2. Statement of the Problem and Research Questions

The business purpose of companies under their constitution is from where the doctrine of *ultra vires* is devised and the power and capacity of companies is delineated to guarantee "creditors and investors that their money cannot be used for a purpose other than the agreed object at the time of investing their money in the company."[18]

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[15]Aderonke Abimbola, (n 4), p. 222

[16]Com. Code, Arts. 363 and 528

[17]Civil Code of the Empire of Ethiopia, Proclamation No. 165, 1960, *Neg. Gaz.* Year 19, No. 2 (hereinafter C.C)

[18]Muhammad Waqas, 'Applications of the Doctrine of Ultra Vires in Developed Countries and Developing Countries' (2014) 4(7) J. Appl. Environ. Biol. Sci. 145

In least developed and developing countries, small companies are seen doing business and tax is collected from newly formed companies through registration fees than business profits.[19] Besides, their economy mainly depends on revenues collected from many companies.[20] Hence, it is in the interest of least developed and developing countries to register more companies by opening their business market for as many companies as possible to take initiatives and develop businesses.[21] Strict adherence of *ultra vires* rule restricts companies to their objects thereby discourages monopolies of large companies and helps various small companies to flourish.[22] Thus, owing to its effect on them the objects clause of companies and *ultra vires* acts and its legal consequences needs to be regulated in the manner that it strikes the interest of shareholders, creditors, third parties, companies and a country's economy.

In Ethiopia, the main legal instrument meant to regulate the formation and operation of private commercial companies is the Com. Code. It requires two important constitutional documents-memorandum and articles of association, containing the business purpose, which needs to be known to the general public and investors, for a company to be formed and registered.[23]

The problem, however, is that the Com. Code provisions that are supposed to regulate private commercial companies are unclear as to whether or not the doctrine of *ultra vires* is introduced in its complete sense. Moreover, the consequence of *ultra vires* acts of companies and their directors and managers is entirely left unregulated. Thus, the understanding of the doctrine of *ultra vires* under the Com. Code and available remedies to shareholders, creditors and third parties against the company and directors and managers that acted *ultra vires* is worthy of inquiry.

Furthermore, though the Com. Code provides for the investigation into the activities and position of a company by the Ministry of Commerce and Industry, now Ministry of Trade and Industry, (hereinafter MoCI and MoTI respectively) at the request of shareholders representing $1/10^{th}$ of the shares or where there has been a resolution of a general meeting or an order of the court or at

[19]Id, p.149

[20]Adarsh Dubey, 'An Analysis of the Doctrine of Ultra Vires from the Indian Perspective' (2019) 5(2) International Journal of Legal Developments and Allied Issues 125

[21]Muhammad Waqas, (n18), p.148

[22]Ibid

[23]Com. Code, Arts. 313, 323, 517 and 520

its own initiation,[24] the available remedies following the undesirable outcomes of the investigation which may have possibly ensued from company's and its directors and managers *ultra vires* acts are left unregulated. Such gap would result in insecurity on the part of shareholders, creditors and third parties plus impact the country's economy. This *lacunae* makes the subject of *ultra vires* worth discussing.

Besides, the need to recognize the role of the law of agency to determine the fate of *ultra vires* transactions of the company and its directors and managers to smoothen the business environment by striking the balance of the interests of various stakeholders of the company and its intended object is momentous to be discussed.

Again, though the Com. Code accommodates flexibility for companies to amend their objects clause, it is devoid of consideration of creditors' interest, who can't participate in the decision making of the amendment of objects clause, and it is arguable whether the interest of minority shareholders, in the absence of stock market, is sufficiently considered. This also is worthy of analysis.

Therefore, based on the aforementioned research problems the following particular questions are subjects of inquiry in this study.

1. Is the doctrine of *ultra vires* recognized by the Com. Code?
2. Why does Ethiopia, being a least developed country, need clear and full-fledged rules on *ultra vires* applicable to private commercial companies?
3. Can the gap on the legal consequences of *ultra vires* acts of a company and its directors and managers be filled by the provisions on law of agency?
4. What should be the fate of *ultra vires* acts of companies and their directors and managers then?
5. How would the interest of creditors and minority shareholders be protected from *ultra vires* acts, under the guise of amendment of objects clause, resulting in dissipating the capital of a company?
6. What does the draft Commercial Code offer with respect to the doctrine of *ultra vires*?

[24]Id, Arts. 381- 383

1.3. Literature Review

As they are fictional persons, companies have no powers or capacity except those granted under their constitution.[25] Their powers or capacity is to be derived from their business purpose- one of the clauses incorporated in the company's constitution registered and deposited in the commercial register for publicity.[26] The business purpose mentions activities of the company from which the doctrine of *ultra vires* may be derived.[27]

Originally, the doctrine of *ultra vires* was introduced to be applicable on public bodies and statutory corporations as they cannot act outside the statutory powers given to them.[28] Later, "[i]t was felt that the same should be true of companies"[29] with the development of the concept of limited liability. Limited liability made applicable to companies made the liability of shareholders limited thereby leaving creditors of companies in unsecured state.[30] Consequently, it was felt pivotal to design the doctrine of *ultra vires*, as a counter part of the principle of limited liability, to ensure that company's fund to which alone creditors could look for payment is not dissipated due to unauthorized activities.[31] Besides, as investors decide to invest owing to company's attractive objects, the concerned company should not employ their money for an object other than those stated in its constitution.[32] Objects clause of a company makes any act outside its terms *ultra vires* and thereby to be declared null and void.[33] *Ultra vires* dealing cannot be ratified by the company and hence cannot be enforced either by the company or third parties.[34]

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[25]Henry Winthrop, 'Proposed Revision of the Ultra Vires Doctrine' (1926-1927) 12 Cornell L Q 453

[26]Michael Andrew, *Essential Corporate Law*, (Cavendish Publishing 2002) 22

[27]James L. Parks 'Ultra Vires Transactions' (1922) 25 (1) Bulletin Law Series 3

[28]Benson Okwuchukwu, 'Ultra Vires Doctrine in Nigerian Company Law vis-à-vis Positions in Ghana and the United Kingdom' 2019 10 (2) NAUJILJ 165

[29]Janet Dine, *Company Law*, (4th Ed, Palgrave 2001) 46

[30]Adarsh Dubey, (n20), p. 126

[31]Simon Goulding, *Company Law*, **(**2nd Ed, Cavendish Publishing Limited 1999) 156

[32]Raghvendra Singh and Nidhi Vaidya, 'Applicability of Doctrine of Ultra Vires on Companies,' <http://ssrn.com/abstract=1558971 > Accessed 25 December 2019

[33]Simon Goulding, (n31), p.156

[34]G.M. Sen, 'Rule of Ultra Vires in Company Law: Has It Outlived Its Purpose?' (1985) 27 (2) JILI 283

The doctrine of *ultra vires* is a legal constraint on company directors and managers ability to act within restricted powers and capacity of companies.[35] The doctrine constrains directors and managers to undertake activities to carry out legal objectives of the company as they are stated in its memorandum of formation.[36] The doctrine is applicable on undertakings by company directors and managers in two ways: when "a particular act of the company is *ultra vires,* it is by necessary implication outside the authority of its directors or agents" as the authority of company agents is linked to company's capacity[37] and when company directors and managers acted beyond their authority despite the very act is *intra vires* to company's capacity.[38]

Indeed, the applicability of the doctrine of *ultra vires* on companies couldn't escape criticism. It has been severely criticized for its strict application being harmful to the interest of third parties that transacted with the concerned company,[39] restrictiveness on the efficiency of companies[40] and ineffectiveness for companies started manipulating objects clause through making it wide and vague.[41] Still, the doctrine is fully effective in developing countries whose economy is largely contingent on revenues collected from various incorporated companies and newly registered ones as the objects clause, from where the doctrine originated, discourages large companies monopoly.[42]

A preliminary literature review in Ethiopia shows that this study, on the legal significance of the applicability of the doctrine of *ultra vires* to private commercial companies, is the first of its kind. Related prior studies were focused on liabilities of directors; in general, than detail analysis of sources of directors' liability, one of which is *ultra vires* act, particularly, due to their act

[35]M.J. Pritchett III, 'Corporate Ethics and Corporate Governance: A Critique of the ALI Statement on Corporate Governance Section 2.01(b)' (1983) 71 (2) CALIF.L.REV. 994

[36]Yedidia Z., 'Corporate Liability for Unauthorized Contracts- Unification of the Rules of Corporate Representation' (1987) 9(4) U. Pa. J. Int'l Bus. L. 649

[37]Lindani Baiketlile, 'Corporate Capacity and Authority of Agents Under the Botswana Companies Act 2003' (LLM Thesis, University of Cape Town 2014), p. 12

[38]Id, p.14

[39]Akio Takeuchi, 'How Should We Abolish the Ultra Vires Doctrine in Corporation Law' (1968) 2 Law Japan 140

[40]Fhi Cassim, 'The Rise, Fall, and Reform of the Ultra Vires Doctrine' (1998) 10 S.Afr. Mercantile LJ 293

[41]Rohan Jajodil, 'The Doctrine of Ultra Vires: The Rise and Fall' **(**2015) 1"Udgam Vigyati"- The Origin of Knowledge 6

[42]Muhammad Waqas, (n18), p. 148

beyond the power conferred on them and objects of the company. The researcher found no contribution made on the importance of defining legal consequences of *ultra vires* acts of companies and their directors and managers, particularly, on the fate of *ultra vires* transactions.

1.4. Objectives of the Study

The role of the doctrine of *ultra vires* on companies has become prominent to company stakeholders and economies of countries, like Ethiopia, where their economies and incorporated business practices are immature. It disciplines companies and their directors and agents as to where and when company's capital is to be utilized thereby enable small companies to flourish. So, the objectives of this thesis are:-

- To explore the application of the doctrine of *ultra vires* on private commercial companies and the potential challenges of legal gaps under the commercial regime of Ethiopia and suggest directions for the revision of the relevant provisions of the Com. Code.
- To analyze rules of law that can be invoked to fill the gaps in the provisions of the Com. Code.
- To articulate possible legal consequences of *ultra vires* acts of companies and their directors and managers and thereby suggest possible remedies for stakeholders.
- To scrutinize, under the existing rules of law, the possibility, if any, whereby the interest of creditors and dissenting minority shareholders is protected from *ultra vires* acts that dissipate the capital of the company under the guise of objects clause amendment.

1.5. Significance of the Study

To start with, this research may serve as an important reference for further comprehensive studies on the subject. It is also believed that this study will inform the law maker and the regulator to introduce clear statutory ground for the application of the doctrine of *ultra vires* on private commercial companies and its legal consequences in consideration of the interests of various company constituencies and the country's economy.

1.6. Scope of the Study

The study focuses on the assessment of the applicability of the doctrine of *ultra vires* on private commercial companies and its legal significance in Ethiopia. It won't consider public enterprises as they are more driven by provisions of public utilities than profit making. Besides, the focus in

this study is on issues of *ultra vires* commercial debts or commitments and their legal consequences. Moreover, as the doctrine of *ultra vires* evolved to prevent misuse of favorable atmosphere created by limited liability, the focus in this study is on SCs and PLCs, not on partnerships whose partners' liability is generally unlimited. To this end, the study mainly analyzes the Com. Code provisions and related laws of Ethiopia, plus literatures on the subject.

1.7. Methodology of the Study

Regarding the methodology, qualitative method is employed for this study. To this end, both primary and secondary sources are used. As a primary source, an intense analysis is carried out on the Com. Code provisions and other laws that have to do directly or indirectly with the applicability of the doctrine of *ultra vires* on private commercial companies by employing doctrinal analysis. Reliance is made on elucidations from literatures like books, journals, unpublished materials and internet sources to expound theories on the subject on the basis of which the adequacy of the Com. Code rules on the issue will be evaluated and used as a premise indicative of what inclusions may be appropriate in the forthcoming commercial code.

1.8. Organization of the Study

The thesis consists of five chapters. The first chapter is devoted to introductory matters where background of the study, statement of the problem and research questions, literature review, objectives and methodology of the study are discussed. The second chapter deals with the general understandings of the notion of corporate existence, limited liability and the doctrine of *ultra vires* followed by chapter three that reviews the applicability of the *ultra vires* doctrine on companies in Civil Law and Common Law jurisdictions. Chapter four is devoted to analysis of the legal significance of application of the *ultra vires* doctrine on private commercial companies in Ethiopia where its applicability and legal consequences are to be scrutinized. Lastly, chapter five presents the findings and puts some recommendations based on the research outcomes.

CHAPTER TWO

2. Understanding Notions of Corporate Existence, Limited Liability and Doctrine of *Ultra Vires* in Companies

2.1. The Notion of Corporate Existence

The essence of a company is that it is a person in law separate from its shareholders.[43] The concept of corporate existence has been long established principle as the key characteristics of properly established company. Once the company is duly incorporated, its existence and business continues despite the continuous change of its shareholders and people running it. It "can own property, commit crimes and conclude contracts" distinct from its shareholders.[44] The concept of corporate existence was splendidly refined by the House of Lords in the Salomon v. Salomon case in England as follow:

> "The company is at law a different person altogether from [its shareholders]: and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form except to the extent and in the manner provided by the Act.....".[45]

The case has established complete separation between a company and its shareholders and those involved in its operation thereby the company is to be treated like any other independent person with all rights and liabilities appropriate to it.[46] Besides, the case has founded that separate existence of a company couldn't be eroded by the sameness of its shareholders and directors.[47] The principle of corporate existence brings several attributes in favor of or against the interest of

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[43] Nicholas Bourne, *Essential Company Law* (3rd Ed, Cavendish Publishing Limited 2000) 1

[44] Ibid

[45] Salomon V. Salomon [1897] AC 22

[46] Endalew Lijalem, 'The Doctrine of Piercing the Corporate Veil: Its Legal Significance and Practical Application in Ethiopia' (LLM Thesis AAU 2011), p.32

[47] Sharon Sheehan, 'Pulling Back The Curtains- Separate Legal Personality and Lifting the Veil,' (CPA2019), <https://cpaireland.ie/Resources/CPA-Publications/Students-e-Bulletin/Relevant-Articles/April-2019/Pulling-back-the-Curtains-Separate-Legal-Personality>Accessed 2 January 2020

the company and its shareholders, *inter alia* the ability of the company to perpetually exist, the ability of shareholders to freely transfer their shares in the company, the ability of shareholders to hold limited liability in respect of fully-paid shares only.[48]

2.2. The Notion of Limited Liability of Companies

Inherent to the formation of modern companies as a separate legal entity, limited liability of a company "refers to a widespread legal principle that limits the accountability of shareholders-owners for the debts of their companies to the current value of their shareholding."[49] That is, it provides shareholders with the privilege of limited liability. Thus, shareholders of a company are exempted from any claims beyond the amount of their subscription in the company whatsoever the source of company's indebtedness.[50] They are liable to pay only the unpaid amount they agreed to contribute in the capital of the company.[51] So, if their company failed to satisfy creditors claim, shareholders can only be called upon to pay the full price of their shares in the capital of the company not for any more.[52] Therefore, limited liability of shareholders is one of congenital attribute that makes limited liability companies popular entity choice.

2.3. The Interaction between Principles of Corporate Existence, Limited Liability and *Ultra Vires* in Private Commercial Companies

As the company exists separately, the liability of its shareholders is limited and thereby they are liable only to the extent of their shareholding except where the law has made exceptions to prevent directors and the management from fraudulent or unfair practices,[53] one being acts *ultra vires* to the objects of the company and their authority. With the principle of limited liability, shareholders are "shielded by the corporate shell of the company and they are liable only to the company to pay what they have agreed at the time of subscription."[54] This impedes creditors whose claims are not satisfied against the company from proceeding against personal properties

[48] Sharon Sheehan, (n47)

[49] Stephanie Blankenburg, Dan Plesch And Frank Wilkinson, 'Limited Liability and the Modern Corporation in Theory and in Practice' (2010) 34 Cambridge Journal of Economics 823

[50] Ibid

[51] Frank H. Easterbrook and Daniel R. Fischel, 'Limited Liability and the Corporation' (1985) 52(1) U Chi L Rev 90

[52] Ibid

[53] Sharon Sheehan, (n47)

[54] Endalew Lijalem, (n46), p.6

of its shareholders. They may recover their debt from the company's property only. This leaves them in an unsecured and miserable condition that demanded a device for their protection which "molded the minds of the pioneers towards the doctrine of *ultra vires.*"[55] Hence, the doctrine of *ultra vires*, as it is applicable to private commercial companies, is established for the protection of, *inter alia*, creditors by hindering companies from exceeding the powers and capacity in their objects clause.

2.4. Applicability of the Doctrine of *Ultra Vires* on Private Commercial Companies

Prior to the development of the doctrine of limited liability, in 1885, the liability of company shareholders was unlimited whereby creditors of the company felt protected on the account of shareholders unlimited liability and didn't demand any other device for their protection.[56] Eventually, however, "creditors found themselves in unsecured and miserable state of affairs", owing to the development of limited liability of companies, that demanded "a device which could protect creditors of companies"[57] thereby the doctrine of *ultra vires* was developed. The "doctrine of *ultra vires* is similar to the law concerning public bodies" which are incapable of acting "outside the statutory powers given to them" as "it was felt that the same should be true of companies." [58]

2.4.1. The Notion and Origin of the Doctrine of *Ultra Vires*

A company is to be formed through public memorandum, containing, *inter alia*, the objects clause of the company, to be registered and publicly known. The object clause of a company delineates its powers and capacity by mentioning lists of activities that the company can undertake and which it cannot exceed. The objects clause of a company in its memoranda was the basis for the development of the doctrine of *ultra vires*, "which dominated the thinking in important areas of company law for over a century."[59] The expression "*ultra vires*" consisting of

[55] Prakash Dhungana, 'Doctrine of Ultra Vires to Third Party Protection: A Changed Philosophy in the Business World' (2009) 3 NJALJ 159

[56] Ibid

[57] Hari Ram, 'Doctrine of Ultra Vires under Companies Act 1956' (PhD Dissertation, MAHARSHI DAYANAND UNIVERSITY 2012), p. 5

[58] Janet Dine, (n29), p.46

[59]Len Sealy and Sarah Worthington, '*Sealy & Worthington's Cases and Materials in Company Law*' (10th Ed Oxford University Press 2013), p.139

two words: '*ultra*' and '*vires*' denotes an act beyond the powers as '*ultra*' means beyond and '*vires*' means powers.[60] In the context of companies, thus, an *ultra vires* act means an act beyond the powers conferred on a company by its objects clause in its memorandum.[61] Originally, it emerged in specific form in the context of statutory companies[62] many of which have been formed to construct public utilities. Its applicability on private companies, however, was not given due attention until the time when the principle of limited liability of companies was developed in 1855.[63] Till then, it was not felt necessary to protect shareholders and creditors as companies "were usually in the nature of an enlarged partnership" and governed by the rules of partnership which impose joint and several liability on partners which was considered adequate to protect shareholders and creditors.[64] But, as the radical development of commercial needs required the liability of companies to be limited, rules in partnerships were found inadequate to protect the interests of all stakeholders[65] which development required a new device of protection for shareholders and non-shareholder stakeholders[66] whereby the doctrine of *ultra vires* was invented to be applicable on private commercial companies.

The doctrine of *ultra vires*, as applied to trading and commercial companies, was the invention of the 19th century English judges[67], particularly, in the leading case of Ashbury Railway Carriage & Iron Co Ltd v Riche.[68] After that case, "the rulings of various courts of different countries have made a great contributions" for its "survival and development."[69] The rule on the nature of the doctrine of *ultra vires*, as applied to trading and commercial companies was, therefore, judge made.

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[60] Prakash Dhungana, (n55), p.159

[61] Ibid

[62] L.S. Sealy, *Cases and Materials in Company Law* (Cambridge University Press 1971)128

[63] Prakash Dhungana, (n55), p.159

[64] Ibid

[65] A.Arjun, 'The Doctrine of Ultra Vires in Sri Lankan Company Act No 7 Of 2007; A Comparative Study on India' <https://www.academia.edu/6547032/The_doctrine_of_Ultra_Vires_in_Sri_Lankan_Company_Act_No_7_of_2007_a_comparative_study_on_India> Accessed 20 December 2019

[66] Prakash Dhungana, (n55), p.160

[67] Leon Getz, 'Ultra Vires and Some Related Problems' (1969) 3 (3) U Brit Colum L.Rev.30

[68] Ashbury (n10)

[69] Hari Ram, (n57), p.5

The doctrine of *ultra vires* was devised to restrict the capacity and powers of companies to carry out only acts that are "expressly or by necessary implication sanctioned by its objects"[70] and the authority of directors and managers to the extent specified under the law and a company's constitution. The doctrine forbids a company from binding itself contractually concerning a matter outside its objects defined in its constitution.[71] Thus, any act of the company outside its objects clause in the memorandum "[is] not simply beyond the authority of the directors [and managers] as a corporate organ, but beyond the capacity of the company itself" and should be null and void, in the eyes of the law.[72] It follows that *ultra vires* act could not be ratified by shareholders, even voting unanimously on a resolution to adopt it.[73] Whereas an act of company directors and managers *ultra vires* to their authority but *intra vires* to the object clause of the company has the possibility to be ratified by the blessing of shareholders resolutions.

2.4.2. The Doctrine of *Ultra Vires* vis-à-vis the Principle of Constructive Notice

The doctrine of *ultra vires* can effectively function in conjunction with the principle of constructive notice only.[74] The principle of constructive notice bases itself on the registration of memoranda and articles of associations. With the requirement of registration of constitutive documents of the company in the commercial register, registered memoranda and articles of association become public documents and can be inspected by anyone.[75] Thus, third parties dealing with the company are deemed to have a constructive notice of the contents of its constitutive documents filed with the registrar and thereby, presumed to know not only the powers and capacity of the company but also the extent of the authority of directors and managers plus any limitations thereon.[76] So, any person who deals with the company in a manner incompatible with the powers of the company stated in its constitutive documents which is *ultra vires* is "prevented from alleging that he did not know that the constitution of the company

[70] A.J. Ikpang **(**Phd), 'Stimulating a Critique on Ultra Vires Doctrine in Nigeria' <http://www.unimaid.edu.ng/oer/Journals-oer/Law/Private%20Law/8.pdf> Accessed 2 December 2019

[71] David Millon, 'Theories of the Corporation' (1990) 1990(2)Duke L.J.201

[72] Len Sealy and Sarah Worthington, (n59), p. 139

[73] Simon Goulding, (n31), p.156

[74] Brian Pillans and Nicholas Bourne, *Scottish Company Law* (2nd Ed, Cavendish Publishing Limited 1999) 57

[75] Mads Andenas and F. Wooldridge, *European Comparative Company Law* (Cambridge University Press 2009) 58

[76] Janet Dine and Marios Koutsias, *Company Law* (8th Ed, Palgrave Macmillan 2014) 47

rendered a particular act or a particular delegation of authority *ultra vires*."[77] The principle of constructive notice "invariably resorted to in support of arguments based on the doctrine of *ultra vires* and its general nullifying effect."[78] The principle, combined with the rule of *ultra vires*, leaves the company and third parties who dealt with it with unenforceable contracts.[79]

2.4.3. The Rationale of the Doctrine of *Ultra Vires*

The rationale behind the development of the doctrine of *ultra vires* was protection of "shareholders and creditors from the [e]xploitation of the commercial advantages associated with the introduction of the concept of limited liability"[80] as the "… radical concept of limited liability had a potential [of encouraging] the fraudulent abuse of investment funds."[81] The doctrine is deemed to protect company shareholders and creditors by restricting the company to pursue only those activities that have the blessing of shareholders and creditors as they are the one who could probably lose their money if the company channeled it in unprofitable adventures not authorized in the objects clause.[82] The doctrine of *ultra vires* assures shareholders and creditors that their investment will not be diverted to an activity they did not contemplate at the time they invested their money in the company.[83] Moreover, the doctrine helps the regulator to discipline companies running businesses in the market through keeping each company within the narrow bounds of specific activities stated in its memoranda.[84] It is also claimed that "the doctrine of *ultra vires* prevents directors from departing the object for which the company has been formed and, thus, puts a check on activities of directors."[85]

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[77] P.C Tulsian, *Company and Compensation Laws* (S. Chand Ltd 2000) 59

[78] CEP (Val) Haynes, T Mugambwa and A Amankwah, *Commercial and Business Organizations Law in Papua New Guinea* (Routledge-Cavendish 2007) 445

[79] Alan Dignam, John Lowry and Chris Riley, *Company Law* (University of London 2016) p.137

[80] A.Arjun, (n65)

[81] Ibid

[82] Jante Dine, (n29), p.47

[83] Leon Getz, 'Ultra Vires and Some Related Problems' (1969) 3 (3) U Brit Colum L Rev 30

[84] Saleem Marsoof, 'The Demise of Ultra Vires and The Protection of Stakeholders under the Companies Act of 2007',<https://www.academia.edu/8212566/The_Demise_of_Ultra_Vires_and_the_Protection_of_Stakeholders_under_the_Companies_Act_of_2007> Accessed 2 December 2019

[85] Raghvendra Singh and Nidhi Vaidya, (n32), p.4

2.4.4. Legal Consequences and Effects of the Doctrine of *Ultra Vires*

A company is to be formed for specific commercial purposes stated in its objects clause in its memoranda.[86] The objects clause in a company's memorandum restricts the company's powers and capacity and the authority of its agents[87] to activities explicitly mentioned therein as company's objects. Any act beyond the objects of the company and the authority conferred on its directors and managers will be *ultra vires* that gives rise to the application of the doctrine.

The doctrine of *ultra vires* proclaims that any contract or transaction of a company the substance of which are purposes not stated in its objects is *ultra vires* and thereby void.[88] Such contracts or transactions of a company cannot be ratified even by the unanimous consent of shareholders.[89] The mandate of shareholders to ratify acts of directors and managers cannot be extended to acts that are beyond the capacity and powers of the principal, i.e., the company.[90] As an agent, directors and mangers can only perform acts their principal- the company, is capable to perform. Moreover, any contract or transaction entered into by directors or managers outside the power conferred on them by the law and the company's constitution but *intra* to the company's objects clause is *ultra vires* thereby voidable.[91] Such realization may end up having the consequence of leaving third parties without remedy or further protection and shareholders without any return from their investment. So, shareholders and non-shareholder stakeholders may resort to the following remedies as an effect of the doctrine of *ultra vires*.

2.4.4.1. Injunction

Shareholders or creditors of a company may be empowered by the law to obtain an injunction against the company in respect of acts proposed to be done outside the company's objects clause stated in the memorandum. Accordingly, in Nigeria, for instance, shareholders and creditors, whose debt is secured by fixed or floating charge, are empowered to seek an injunction order to

[86] LE Talbot, *Critical Company Law* (Routledge Cavendish 2008) 100

[87] Ben Pettet, *Company Law* (2nd Ed, Pearson Longman 2005) 161

[88] LE Talbot, (n86), p.100

[89] Wiley, 'Ultra Vires In Modern Company Law ' (1983) 46(2) The Modern Law Review 204

[90] Yohana Gadaffi and Miriam Tatu, 'Derivative action under the Companies Act 2015: New Jurisprudence or Mere Codification of Common Law Principles?' (2016) 2(1) Strathmore Law Journal 75

[91] LE Talbot, (n86), p.100

prevent the doing of an act *ultra vires* to the objects of a company or the powers of its directors and managers.[92] An injunction order is a remedy for shareholders to restrain a company acting *ultra vires* from proceeding with it, in the UK, Nigeria and Ghana too.[93]

2.4.4.2. Tracing

Tracing is a relief available for the lender that s/he may recover her/his money or products if found that the money or the product lent by the company, acting *ultra vires* to its object, is not spent and is in its original form and capable of identification.[94] The relief of tracing is effective as much as "the money of the lender is in the hands of the company in its original form or its products are still capable of identification."[95] It is more difficult for creditors to trace their money and products if it is mixed up with the company's money and products.

2.4.4.3. Subrogation

The relief of subrogation enables *ultra vires* lenders of a company whose money is used to pay off lawful debts of the company to step into the position of the debtor paid off and claim his/her money to the extent s/he would have the right to recover his/her loan from the company.[96] The limitation in such kind of subrogation, however, is that it does not give the lender priority over other creditors.[97]

2.4.4.4. Personal Liability of Directors and Managers

Shareholders and non-shareholder stakeholders may bring action against company directors and managers who acted beyond the powers and capacity of the company in breach of their duty to make sure that "the funds of the company are being utilized only for lawful businesses of the company within the frame of their authority" in the company's memorandum.[98] Moreover, directors who appeared to third parties as if the contract they entered into, on behalf of the

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[92] Aderonke Abimbola, (n 4), p.227

[93] Benson Okwuchukwu, (n28), pp.169-173

[94] Muhammad Waqas, (n18), p.147

[95] 'Consequences of Ultra Vires Transactions/Actions', p.196 <http://shodhganga.inflibnet.ac.in/bitstream/10603/9793/12/12_chapter%205.pdf > Accessed 20 February 2020

[96] Id, p.208-209

[97] Muhammad Waqas, (n18), p.147

[98] Adarsh Dubey, (n20), p.132

company, is within the powers of the company, while in reality the company has not such powers under its memorandum, will be personally liable to third parties' loss on account of breach of warranty of authority.[99]

2.5. Criticisms against the Application of the Doctrine of *Ultra Virus* on Companies

The doctrine of *ultra vires* when applied on companies gives the possibility to both the company and third parties dealing with it to escape liability for an act done in the company's name by directors and managers on the ground that it was *ultra vires* to the company's objects and authority of agents.[100] Accordingly, the doctrine of *ultra vires* has been criticized for it enables the company to escape liability though it caused damage to creditors[101] and for it enables creditors to escape liability even if they caused damage to the company.[102] Besides, the doctrine has been criticized for the hardship it causes to a company's management as it restricts their activities and requires them to check whether the acts sought to be done are covered in the objects clause of the company.[103] Further, the doctrine has been criticized for hardships it caused to innocent third parties as it thwarted their legitimate expectations and instigated extra cost and delay in the course of checking whether the transaction they undertook with the company is within its objects.[104]

[99] Consequences of Ultra Vires Transactions/Actions, (n95) p. 230

[100] 'Doctrine of Ultra Vires as Applied to Business Corporations' (1919) 32(3) Harv.L.Rev. 279

[101] Raghvendra Singh and Nidhi Vaidya, (n32), p.10

[102] R. Baxt, 'Is the doctrine of ultra vires dead' (1971) 20(2) ICLQ 301,307

[103] Ali Khaled (PhD), 'The Rule of Ultra Vires in Company Law: Understanding English Perspectives and Legal Issues' (2017) 28(12) ICCLR 457,459

[104] Id, p.458

CHAPTER THREE

3. Applicability of the Doctrine of *Ultra Vires* on Companies in Civil Law and Common Law Legal Systems

Though the doctrine of *ultra vires* applied on private commercial companies was first coined by UK judges and developed with the inclusion of company's objects clause in its memorandum required by the 1856 Act,[105] it has evolved and adopted in most common and civil law jurisdictions which still require companies to state their objects clause upon incorporation.[106] The theme of this chapter is, therefore, to analyze how the *ultra vires* doctrine, as applied on private commercial companies, is understood and treated in both common and civil law jurisdictions.

3.1. Applicability of the Doctrine of *Ultra Vires* on Companies in Common Law Legal System

Conventionally, the doctrine of *ultra vires* is a common law doctrine, particularly, English company law which "shaped the corporate laws of most of the countries following the common law"[107] which underscores that company's transaction must be within its objects clause and those activities that go beyond its objects clause is *ultra vires* thereby null and void.[108] In those jurisdictions, a company doesn't have legal capacity to carry on a "business activity which was not explicitly or by necessary implication, included in its objects clause" in its memoranda.[109] "[I]f the company did nevertheless engage in business activity falling outside its objects clause, the courts declared such business activity *ultra vires*, and therefore void."[110]

As addressed in common law jurisdictions, the doctrine of *ultra vires* is also made applicable to company agents', in the sense that they cannot act beyond the authority conferred on them by the

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[105] Syed Razai, Ashraf Ali and Suhail Shahzad, 'The "Doctrine of Ultra Vires" and Its Subsequent Development in the Frame Work of Company Law' (2014) 45 (65) Journal of Law and Society 141

[106] 'Company Law in Europe: Recent Developments,' (A survey of recent developments in core principles of companies regulation in selected national systems, 1999), p.6

[107] Ali Khaled (PhD), (n102), p.457

[108] <https://www.coursehero.com/file/p3so4bt/At-common-law-the-doctrine-of-ultra-vires-refers-to-a-companys-transaction-must/> Accessed on 7 March 2020

[109] Stephen J, 'Rise and Fall of the Ultra Vires Doctrine in United States, United Kingdom, and Commonwealth Caribbean Corporate Common Law: A Triumph of Experience over Logic' (2006) 5DePaul Bus & Comm LJ67

[110] Ibid

law and company constitutions. Thus, any act of company directors and mangers beyond the authority conferred on them is *ultra vires*. The common law position is that directors and managers who disposed company's asset without authority are strictly liable for the loss caused[111] except when the act is within the object of the company and is ratified.

However, with the passage of time and development of company law, the doctrine of *ultra vires* was criticized in different common law jurisdictions and others whose commercial regime was influenced by common law legal system.[112] It was in light of modern day economic realities which it couldn't go with, for it hindered commercial transactions and economic development through restricting companies from engaging in activities they deemed lucrative that the doctrine has been criticized.[113] It was also criticized for it endangered the interest of third parties in good faith, encouraged blatant corporate wrong doing and not effective as companies are enlarging the objects clause which the doctrine is not in control of.[114] Consequently, "different common law jurisdictions adopted variations to the traditional *ultra vires* doctrine, weakening its strict application."[115] Accordingly, in England, following its entry into the European Community,[116] the strictest application of the doctrine of *ultra vires* was eroded gradually through enduring amendment of Companies Act in which the process allowed the company to "amend its memoranda to add additional business activities in its objects clause or clauses."[117] Companies, in England, are prevented from using the *ultra vires* doctrine as a sword "against innocent third parties in any effort to invalidate otherwise valid transactions" for the requirement of the inclusion of objects clause" in their memoranda is totally abolished.[118] Indeed, the demise of the doctrine was not absolute and exceptions have been introduced in different common law

[111] Sarah Worthington, 'Corporate Governance: Remedying and Ratifying Directors' Breaches,' (2000) 116L.Q.Rev. 638

[112] Benson Okwuchukwu, (n28), P.173

[113] Ibid

[114] Saleem Marsoof, (n84), pp.3-4

[115] Manal Bensafi, Laura Gomez and Caroline Greco, Companies Capacity to Contract in European Civil Law and Common Law countries (2017), <https://www.acc.com/resource-library/companies-capacity-contract-european-civil-law-and-common-law-countries#> Accessed on 1 March 2020

[116] Stephen J Leacock, (n109), p.75

[117] Id, P.81

[118] Id, p.87

jurisdictions too, such as in Ireland where *ultra vires* doctrine is still applicable to special purpose vehicles (SPVs) companies which are prohibited from entering into transactions other than those stated in the objects during formation.[119] Consequently, it is said that "there is little sign of European jurisdictions adopting the North American idea of giving companies full powers of a natural person."[120]

On the other hand, it is said that, in the United States, persuaded to give companies full power of a natural person, the abolition of the *ultra vires* doctrine probably came closest to being complete.[121] Thus, a company may "do every mortal thing that it wants, provided that the particular activity is lawful for an individual to pursue."[122] Yet again, since legal consequences of *ultra vires* acts such as proceeding by the Attorney General for judicial dissolution of a company found engaged in *ultra vires* acts, proceedings by shareholders for injunction to restrain the company from engaging in an *ultra vires* act or acts, and proceedings against personal liability of directors and agents responsible for *ultra vires* act or acts have been retained, it cannot be said that the doctrine has been entirely abolished in the United States.[123]

3.2. Applicability of the Doctrine of *Ultra Vires* on Companies in the Civil Law Legal System

The *ultra vires* doctrine, despite the fact that it originated in common law jurisdictions, was accepted by, if not all, most civil law jurisdictions.[124] Accordingly, in France, the powers of corporations and limited liability companies were always required to be exercised within the *object social* of the corporation or the company as stated in the memorandum.[125] The term "*object social"* in French's company law denotes the objects clause of companies. The doctrine of *ultra vires*, called *objects social* doctrine, is still retained, in France, while its New Company

[119] Manal Bensafi, Laura Gomez and Caroline Greco, (n115)

[120] Company Law In Europe: Recent Developments, (n106)

[121] Stephen J., (n109), p.95

[122] Ibid

[123] Id, pp.95-97

[124] Robert Drury, 'A Review of the European Community's Company Law Harmonization Programme' (1992) 4BLJ46

[125]H.J. Ault, 'Harmonization of Company Law in the European Economic Community' (1968) 20(1)Hastings LJ77, 104

Law brought increased protection to third parties with respect to attempts to internal limitations on the powers of directors or managers.[126] Hence, as yet, corporations and limited liability companies need to incorporate the objects clause of the company in their memoranda. Thus, company directors and managers may exercise their power of representation only within the limits of the company's objects clause thereby a commitment on the part of a company may not be enforceable on the ground that it doesn't fall within the objects clause of the company.[127]

On the contrary, Germany law firmly rejects limitation on the powers and capacity of companies through the *ultra vires* doctrine so far as dealings with third parties are concerned. "There is no *ultra vires* rule in operation."[128] This doesn't mean, however, that directors and managers have unlimited power of representation, which "would be unworkable as well as unnecessary to fulfill the commercial needs for legal security."[129] Some limitations such as requirement of shareholder or Supervisory Council approval of certain important corporate actions and the company not to be bound by transactions with third parties who knew or should have known of limitations on managers' power have been developed.[130]

So, the comparison of the French and Germany's legal system on rules of *ultra vires* reveals that while French law has "developed to protect the shareholder by allowing the company to avoid commitments in certain circumstance,……the interests of third parties have always been preferred," in Germany law.[131] Moreover, the doctrine of *ultra vires*, though in attenuated form, still remains intact in other civil law countries such as Belgium and Switzerland, as the business purpose of companies is still required to be included in company memoranda upon incorporation and *ultra vires* rule applies.[132] *Ultra vires* rule is maintained to "bind third parties who are aware of the transgression."[133]

[126] Id, p.106

[127] Ibid

[128] Company Law In Europe: Recent Developments, (n106), p.28

[129] H. J. Ault, (n125), p.102

[130] Id, p.109

[131] Id, p.106

[132] Company Law In Europe: Recent Developments, (n106)

[133] Id, p.15

In general, "the review of the law governing the capacity of companies across jurisdictions somehow shows incoherent evolution."[134] Some civil law jurisdictions adopt regimes that extend the protection given to companies, while certain common law countries appear more concerned with facilitating commercial activity and safeguarding the interest of third parties.[135]

There is little sign of European jurisdictions adopting the North American idea of giving companies full powers of a natural person in the harmonization process of company laws of the European Economic Community member countries.[136]

Looking into the powers of company directors and managers to enter into transactions that bind a company, in civil law jurisdictions, their power may be limited either through explicit provisions in the by-laws or charter of the company or the objects clause of the company itself.[137] Accordingly, in France, despite no reference is made to the effect of limitations on the power of company agents, courts faced with a problem of how to treat these limitations resorted to by the general principle of agency law as codified in the *Code Civile* in which case an agent can do nothing beyond the authority conferred on him.[138] Applying this concept in company context, they conclude that "limitations on the powers of corporate representatives were effective against third parties" and a company was "not bound by an act done by the agent outside the scope of the mandate unless [it] ratifies the act."[139] A *contrario*, the German law, with clear reference to its effect, has firmly rejected the limitations on company agents "so far as dealings with third parties are concerned."[140]

[134] Manal Bensafi, Laura Gomez and Caroline Greco, (n115)

[135] Ibid

[136] Company Law In Europe: Recent Developments, (n106)

[137] H. J. Ault, (n125), p.101

[138] Id, p.104

[139] Ibid

[140] Id, p.101

CHAPTER FOUR

4. Applicability and Legal Significance of the Doctrine of *Ultra Vires* on Private Commercial Companies in Ethiopia

It is to be understood from the notes in the legislative background document of the Com. Code that the drafter had always in mind the interest of Ethiopia with the aim to encourage, someday, "the investment of Ethiopia savings in large, broad-based enterprises without at the same time discouraging the contribution of foreign capital," rather than considering preference to be given to either the Continental or Anglo American Legal system.[141] Hence, the focus of the drafter was to choose the best solutions no matter where they come from.[142] In this respect, the drafter had followed eclectic approach rather than selecting civil law or common law approach in drafting the Com. Code. So, it can be said that the Ethiopian company law is influenced by both the civil and common law legal systems though, in general, it is said Ethiopia belongs to the civil law legal system.[143] The nature of the Com. Code provisions dealing with the doctrine of *ultra vires* will be discussed, accordingly, as follow.

4.1. An Overview of Private Commercial Companies in Ethiopia

The Com. Code of Ethiopia has designated business organizations as commercial and civil based on objects and form.[144] Accordingly, business organizations established in the form of partnership, except ordinary partnership, with objects, under the memoranda of associations or in fact, of carrying on any of the commercial activities specified in Art. 5 of the Com. Code are deemed commercial while SC and PLCs are always deemed commercial irrespective of their objects of business engagement.[145]

The fundamental attribution that distinguished SCs and PLCs from partnerships is the privilege of limited liability given to their shareholders[146] as a result of which creditors of these companies

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[141]Peter Winiship (Editor and Translator), *Background Document of Ethiopian Commercial Code of 1960*, (Faculty of Law, Haile Selassie I University, Artistic Printers, Addis Ababa, 1972), P. 61

[142] Ibid

[143]Endalew Lijalem, (n46)

[144] Com. Code, (n14), Art. 10

[145] Ibid

[146] Id, Arts. 304/2, 510/1

are in unsecured state of getting back their money if the company failed to satisfy their claim, *inter alia*, for the money is squandered in pursuit of unauthorized activities. Thus, it is deemed proper that utilization of shareholders' and creditors' funds by these companies should be only for the proper purpose using the *ultra vires* doctrine that confines them only to activities stated in the objects clause in the memorandum of associations.

4.2. The Role of the Doctrine of *Ultra Vires* in Ethiopia

In Ethiopia, given that the culture of incorporating businesses is at its very low stage, the *ultra vires* doctrine, applied to private commercial companies, plays an important role towards improving corporatization by disciplining companies and their directors and managers as to where the capital of the company is to be utilized. Strict adherence of companies to the doctrine of *ultra vires* prevents them from doing businesses outside their objects which in turn discourages monopolies of large companies and encourages business-minded persons "to register new companies as the object clause of a company may not cover all aspects of [businesses]."[147] Applying the doctrine makes the business market open for a number of companies to take initiatives and develop businesses upon which small companies will be able to flourish.[148] The existence of many companies mean there will be competition between them which would contribute for the enhancement of consumers' welfare. In turn, as the economy of least developed countries, like Ethiopia, is mainly dependent on the revenue collected from various companies, from where tax is collected through registration fees, their flourishing contributes towards the enhancement of countries' economy.[149] So, it is a matter of utmost importance to ascertain the legal capacity of private commercial companies and consider the consequences and effects of acts beyond their capacity.[150] Thus, noting that the role of the *ultra vires* doctrine applied to private commercial companies in enhancing culture of having businesses incorporated in Ethiopia would thereby improve the country's economy, beyond creditors and shareholders protection, may not be underestimated. Moreover, since the management of private commercial companies is run by directors and/or managers, defining the extent of their powers and liabilities,

[147] Muhammad Waqas, (n18), p.148

[148] Ibid

[149] Ibid

[150] Charles S., 'Doctrine of Ultra Vires in North Carolina (1942) 20 NC L Rev 405

too, is the subject of the doctrine of *ultra vires* which makes it equally important to discipline the management to act within authority.

4.3. Applicability of the Doctrine of *Ultra Vires* on Private Commercial Companies in Ethiopia

Formation of private commercial companies in Ethiopia shall be through having public memoranda which shall contain, among others, the companies' business purposes.[151] The business purpose required to be included in the public memoranda defines and regulates the status, powers and capacity of private commercial companies. The business purpose or objects clause of companies stated under their public memoranda contains activities they are required to carry out.

Besides, the memoranda of private commercial companies, fulfilling the legal requirements, are required to be publicized through registration and deposit of documents in the commercial register.[152] Publicity requirement of public memoranda by which a company is formed implies that third parties who transact with the company are duty bound to check the capacity of the company to be bound by the transaction it enters into.[153] The availability of companies' memoranda as public documents for inspection, therefore, has the effect of ascribing the notice of the content of these documents on persons who dealt with such companies.[154] The requirement of the inclusion of objects clause of companies in their public memoranda and its publicity enables shareholders and outsiders who deal with them know the businesses they are permitted to undertake and limits therein, their capital and their relation with outsiders.[155] They enable prescribers and prospective shareholders or creditors of these companies know where or on what activities they are putting their money into by investing in or contracting with the companies.[156]

The objects clause of private commercial companies defined in their public memoranda is to be continued as their objects until changed through the amendment of the memoranda themselves,

[151] Com. Code, (n14), Arts. 313, 516, 517

[152] Id, Arts. 323 cum 219-224, 520 cum 219-224

[153] Wellalage Indira, (n6), p.41

[154] Ibid

[155] Benson Okwuchukwu, (n28)

[156] Lois M., 'Why Kenya Should Reconsider its Ultra Vires Doctrine in Corporate Law' **(**2010) 21(9) ICCLR301

which need to be registered and deposited in the commercial register, in compliance with prescribed procedures.[157] Amendment of the substantive aspects of the objects clause of the company in a draft public memorandum of a SC under formation requires the approval of all subscribers.[158] Besides, it is only extraordinary meetings with the two-thirds majority vote that may amend the memoranda of an incorporated company, including change in its objects.[159] Moreover, though unclear and arguable, it appears that amendment of objects clause of PLCs may only be amended through, unless a larger majority is provided in the articles of association, a majority vote of members representing three-quarters of the capital.[160]

Thus, the objects clause of private commercial companies, once they are settled and the memoranda filed would be binding them and unalterable except through amendment in compliance with the required quorum and majority vote of shareholders, who have an unfettered discretion as to the objects to which their company shall be empowered to devote itself.[161] Here, an overview of the draft Commercial Code reveals that all the above mentioned rules in respect of the objects clause of private commercial companies are retained[162] and thereby, the doctrine of *ultra vires* is endorsed.

All these rules relating to objects clause of private commercial companies in Ethiopia are aimed at delineating the capacity of companies to the defined objects and thereby limiting their contractual and transactional power. So, it is of paramount importance that objects clause of private commercial companies shall fully and clearly set out their activities[163] to deter them from exceeding their capacity as well as deter the management from engaging in transactions, exceeding their authority, on businesses regarding which companies are not authorized.[164] Accordingly, any act outside the business purposes contained in the constitutional documents

[157] Com. Code, (n14), Arts. 322/4, 462 cum 423, 536

[158] Id, Art. 322/4

[159] Id, Arts. 462 cum 423

[160] Id, Art. 536. Since articles of association is deemed part and parcel of the memorandum of association and required to be attached thereto, pursuant to Art. 518 cum 314 of the Com. Code, it could be argued that changes to objects clause of private limited companies can be made through amendment of articles of association.

[161]Harry Farrar, *Company Law* (4th Ed, Cassel & Co. LTD 1955) p.44

[162] See The Draft Commercial Code, Arts. 86ff, 213, 215, 291, 301, 509, 510

[163] Harry Farrar, (n161)

[164]Aderonke Abimbola, (n4)

should be declared *ultra vires*. Otherwise, it would be meaningless to require the inclusion of objects clause in a company's memoranda and put stringent requirements for its amendment. Besides, allowing companies to do business beyond those activities mentioned in their objects clause causes the dissipation of their capital leading to bankruptcy which is worrisome to creditors as the scenario threatens the retrieval of their money. Utilization of shareholders money other than for the object they deemed profitable is also frightening to them.

Equally, the applicability of the doctrine of *ultra vires* on private commercial companies could also be relevant to cases of lack of authority by directors and managers despite the fact that their act is within the objects of the company. Pursuant to Art. 363/1 of the Com. Code, powers of directors of SCs emanate from the law, the memorandum or articles of association and resolutions passed at shareholders meetings. They are empowered to undertake only those activities allowed by the law, the company's memorandum and articles of association and resolutions whereby any act of SCs directors beyond the power conferred on them outside of the three sources will be *ultra vires*.

Likewise, the power of managers is restricted to carry out only acts of management connected with the exercise of the business of a SC within its objects including the power to sign negotiable instruments.[165] Thus, unless expressly authorized to do so, a manager of SC is prohibited from sell or pledge immovable property nor may sell, hire or pledge a business.[166] Any act of managers of a SC beyond acts of management and exterior to expressly authorized activities will be *ultra vires*. Conversely, save the power to undertake general acts of management, Art. 352 of the draft commercial code broadens the power of managers to include, *inter alia*, implement the decisions of directors, prepare the company's plan and budget and submit it to the board for approval and implement it upon approval.

In contrast, managers of PLCs are bestowed full powers within the objects of the company.[167] Yes, the powers of PLC managers may be restricted by the articles of association, but, such restriction is binding only as between members and managers, not on third parties, though

[165] Com. Code, (n14), Art. 348/3 cum 35/1

[166] Id, Art. 348 cum 35/2

[167] Id, Art. 528

properly published[168] i.e. like the Germany's regime, the law has rejected restrictions on the power of PLC managers so far as dealings with third parties are concerned. In respect of their relation with the company, however, PLC managers are required to comply with such restrictions and any act beyond the limits of their powers will be *ultra vires*. Looking into the draft commercial code, the possibility for PLCs to be managed by directors, if decided to the same effect in the memorandum, is implied under Art. 520. If not, like the existing Com. Code, it is implied under its Art. 522 that PLC managers are empowered to undertake all activities within the objects of the company save restrictions in the memoranda applicable to their relation with the company only.

4.4. Legal Significance of the Doctrine of *Ultra Vires* on Private Commercial Companies in Ethiopia

In this part, the legal attention given to the doctrine of *ultra vires*, as applicable to private commercial companies, under the Com. Code and related laws of Ethiopia are to be scrutinized. Owing to this, the applicability of the doctrine in respect of private commercial companies can be invoked either when an act itself is beyond the capacity of the company or when the directors and managers of companies are found having acted beyond their authority. The legal significance and consequences of the doctrine both in respect of company and its agents will be discussed as follow.

4.4.1. Legal significance of the Doctrine of *Ultra Vires* Applicable on Acts of Private Commercial Companies

In Ethiopia, as noted earlier, private commercial companies are required to be formed by public memoranda which shall contain, *inter alia*, the company's business purpose.[169] Furthermore, the public memoranda containing the business purposes of both SCs and PLCs and any modifications therein is required to be publicized through registration and deposit in the commercial register and a notice published in a newspaper empowered to publish legal notices.[170] Similar requirement of registration and publicity of formation of private commercial companies is provided under Art. 7 of the Commercial Registration and Licensing Proclamation

[168] Ibid

[169] Com. Code, (n14), Arts. 313, 516 and 517,

[170] Id, Arts. 323(1,2) cum 219 and 224, 520 cum 219 and 224

No. 980/2016 (hereinafter the Commercial Registration and Licensing Proclamation), except that publication is required to be made on a newspaper having nationwide circulation at the time of establishment, instead of a newspaper empowered to publish legal notices.[171] The commercial register is required to be open to the public and third parties are entitled to look into the register[172] and be informed of the affairs of the company including its objects. Publicity of a company brings about legal existence and personality notwithstanding that all the legal requirements relating to formation have not been complied with.[173] Where the interests of creditors or shareholders are endangered by the legal or statutory requirements not having been complied with, however, courts have the mandate to order, on the application of any such creditor or shareholder, the dissolution of the company and such provisional measures as may be necessary.[174] One of the legal requirements to be complied in the formation of private commercial companies is inclusion of the business purpose of the company in its memoranda. So, whenever creditors or shareholders discover that their interests are endangered due to failure by company incorporators to comply with the legal requirement of defining the objects of the company, they may apply for court order, 'within three months from the date of publication of the memorandum in the official commercial gazette,'[175] for provisional measures and the dissolution of the company as the case may be. The business purpose of private commercial companies restrains the company and its directors and managers to the authorized functions and activities only.

Besides, it is implied from the provisions of Arts. 29/1/e and 30/1/c of the Commercial Registration and Licensing Proclamation that a private commercial company cannot utilize the business license issued to it for unauthorized purpose. Thus, a private commercial company's business license may be subjected to suspension and revocation if it is found engaged in unauthorized purpose.[176] Moreover, registration of private commercial companies could be

[171] Commercial Registration and Licensing Proclamation, 2016, Proc. No. 980, Neg. Gaz., Year 22, No. 101, Art. 7(1,2)

[172] Id, Art 7/3

[173] Com. Code, (n14), Arts. 324/1, 520 cum 223 and Id, Art. 7/1

[174] Id, Arts. 324, 520/3 cum 324

[175] Id, Art. 324/3

[176] Commercial Registration and Licensing Proclamation, (n166), Arts. 29/1/e and 30/1/c

cancelled whenever they are found to have violated the Commercial Registration and Licensing Proclamation or regulations and directives issued for its implementation,[177] found engaged in unauthorized purpose could be one. These mandatory provisions do imply that the legal capacity of private commercial companies is contained to those activities stated in their objects clause and thereby implying that their directors and managers have to comply with them. Any act of a private commercial company outside the ambit of its objects is beyond its legal capacity and thereby should be declared *ultra vires* and shouldn't be ratified even by unanimous vote of shareholders. Such restriction protects shareholders and creditors as directors and managers are restricted in their business choice to that which shareholders and creditors had initially invested money to fund, i.e. it prevents company agents from dissipating their money in unauthorized businesses.

Besides, though the Com. Code provides flexibility for private commercial companies to amend their objects clause and include activities other than those mentioned therein, it could be argued that stringent compliance requirement of two-third majority of extraordinary meeting of shareholders in SCs and a majority vote of the members representing three-quarters of the capital in PLCs, would make the alteration/amendment difficult.[178] The law gives some level of flexibility to companies to amend their objects clause while it puts stringent requirements to restrain them from free dissipation of creditors and shareholders money. Thus, arguably, the stringent requirement in the amendment of objects clause of companies appears to balance the interests of companies to amend their objects clause and the interests of creditors and shareholders who want their money not to be squandered in risky businesses.

All these created favorable conditions for the argument that the doctrine of *ultra vires* is acknowledged to be applicable on private commercial companies in Ethiopia. Therefore, it can be argued that the commercial regime of Ethiopia has given recognition to the applicability of the doctrine of *ultra vires* on private commercial companies, though not explicitly.

The legal recognition given to the doctrine of *ultra vires* in respect of its applicability on private commercial companies is to be blamed for its incompleteness: Ethiopia's commercial regime has failed to determine the fate of *ultra vires* contracts and transactions. Again, the commercial

[177]Id, Art. 11/1/d

[178] Com. Code, (n14), Arts. 322/4, 462 cum 423, 536

regime of Ethiopia is to be impugned for its failure to sufficiently guarantee the interest of minority shareholders who dissent to the majority shareholders decision to amend company's objects. Despite the fact that minority shareholders of a SC are allowed to withdraw from the company and have their shares redeemed, at the average price on the stock exchange over the last six months, from the change in the objects clause of the company,[179] this is not yet to be enforced in the absence of stock market since the country has not yet established stock market thereby making it difficult to know the average price of a share.[180] Moreover, the company's redemption of shares at a price proportionate to the company's assets as shown in the balance sheet for the last financial year might not be advantageous to the leaving shareholder as compared to the price of the share to be determined on stock market. Worse, the law is silent on the exit right of minority shareholders of PLCs who dissent to the majority shareholders' decision to amend company's object. The only protection available to minority shareholders that dissented to majority shareholders' decision to amend company's objects clause is not to be forced to increase his/her investment.

So, owing to the aforementioned legal and practical loopholes it is hardly possible to argue that the commercial regime of Ethiopia has sufficiently protected the interest of minority shareholders who dissent to the majority shareholders' decision to amend the company's objects.

4.4.1.1. Legal Consequences of *Ultra vires* Acts of Private Commercial Companies

The principle of *ultra vires* in companies is based upon their legal capacity. The legal capacity of private commercial companies is limited to exercising activities stated in their objects clause in their memoranda. They lack the requisite legal capacity to undertake an act beyond their objects clause, the validity of which is to be called into question.[181] Any act beyond the legal capacity of private commercial companies is to be declared *ultra vires* thus "no legal relationship or effect ensues there from" and cannot be ratified even by the unanimous consent of shareholders.[182] In effect, neither the company nor third parties who dealt with the company can invoke the

[179]Id, Art. 463/1

[180] Alemu Taye, 'Protecting Minority Shareholders in Ethiopian Share Company Law: The Practice in Bahir Dar' (LLM Thesis, BDU 2015), p.44

[181] Andrew Griffiths, *Contracting with Companies* (Hart Publishing 2005) p.99

[182] Scope Application and Consequences of the Doctrine of Ultra Vires, <https://shodhganga.inflibnet.ac.in/bitstream/10603/132428/9/09_chapter%203.pdf> Accessed on 14 March 2020

enforcement of *ultra vires* contracts or transactions against each other.[183] Accordingly, shareholders and non-shareholder stakeholders need to resort to other legal remedies, other than enforcement of *ultra vires* acts.[184]

In Ethiopia, primarily, it is the Com. Code provisions that are meant to regulate private commercial companies expected to define their powers and capacity and the legal consequence of their *ultra vires* acts. Accordingly, it is required that private commercial companies shall be formed by public memoranda containing, *inter alia*, the objects clause of the company which defines their powers and capacity.[185] An act exterior to activities stated in the objects clause of the company in its memoranda is beyond its legal capacity, the legal fate of which should be determined in clear terms.

The problem with the commercial regime of Ethiopia, however, is that, despite the objects clause that is meant to define the legal capacity of companies is required to be stated in its memorandum; the legal consequence of acts beyond companies' legal capacity- *ultra vires* acts, in violation of the law, is not yet defined. Besides, though the Com. Code provides for the possibility of investigation into the activities and position of a SC by the MoTI, at the request of shareholders representing 1/10th of the shares or where there has been a resolution of a general meeting or an order of the court or at its own initiation,[186] it doesn't provide for the consequence of undesirable outcomes of investigation which may ensued from, *inter alia*, acts beyond the company's capacity. This left shareholders and creditors, whose interests are affected due to *ultra vires* contracts and transactions, under the state of uncertainty as to available remedies to get back their money utilized in unauthorized activities. Also, the absence of clear rule to regulate the consequence of investigations that discover undesirable outcomes may ultimately affect the country's economy as the investigation will be meaningless in the absence of remedial measures against *ultra vires* acts "to keep the company within the narrow bounds of specific activities authorized to carry out."[187] Even, had the Com. Code clearly spelt out the consequence

[183] James L. Parks, (n27), pp.10-11

[184] Adarsh Dubey, (n20), p.132

[185] Com. Code, (n14), Arts. 313, 516 and 517

[186] Id, Arts. 381- 383

[187] Saleem Marsoof, (n84)

of *ultra vires* acts, it would have added one point more for good corporate governance thereby encouraging investors to invest their money in the companies.[188]

Of course, looking into the Commercial Registration and Licensing Proclamation, utilization of a business license for unauthorized purpose is stipulated as a ground for suspension and revocation of a private commercial company's business license.[189] Moreover, the registration of a private commercial company which utilized its business license for unauthorized purpose could be cancelled and the company dissolved.[190] Even according to the Com. Code, creditors or shareholders may apply for provisional measures and/or dissolution of a company that endangered their interests due to its failure to comply with the legal requirement of including objects clause in its memoranda.[191]

However, rules of *ultra vires*, both under the Com. Code and the Commercial Registration and Licensing Proclamation, are limited to the validity or not of the company's business license and its continuation in operation or not. Both have failed to regulate what should be the fate of *ultra vires* contracts and transactions, beyond order of suspension and revocation of business license and dissolution of a company. Even the proposed draft commercial code doesn't seem to have come up with clear provisions on the issue. Absence of such clear rules determining the legal consequences of *ultra vires* contracts and transactions leave questions like: - should *ultra vires* contracts and transactions be enforced against the company and third parties?, and *vice versa* or should the company be liable for third parties' claim based on contracts and transactions done beyond its legal capacity?, and should third parties be liable for the claims of a company the basis which is an act beyond its legal capacity?, unanswered.

As a matter of principle, in the presence of the requirement of inclusion of objects clause in a company's memorandum, the capacity of private commercial companies' is limited to carry out only those activities stated in their objects clause.[192] Any act outside the activities stated in the objects clause of companies is beyond their legal capacity and has to be declared *ultra vires*.

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[188] የባለሙያዎች ቡድን, 'የኢትዮጵያ የንግድ ማህበራት ሕግ የፖሊሲ ጉዳዮችና የማሻሻያ ሐሳቦች,' (የካቲት, 2006)

[189] Commercial Registration and Licensing Proclamation, (n166) Arts. 29/1/e and 30/1/c

[190] Id, Art. 11/1/d

[191] Com. Code, (n14), Arts. 324, 520/3 cum 324

[192]Lindani Baiketlile, (n37), P.12

Under the rule of *ultra vires*, thus, a company is restricted from undertaking business activities which are not within the ambit of its capacity in its objects clause. Any act of companies without the requisite legal capacity cannot be legally validated in any way. Because, the company defaulted to comply with the legal requirement to act within the limits of its capacity should not be allowed to claim for the enforcement of contracts and transactions done without the requisite legal capacity i.e. shouldn't benefit from its unlawful act. So, an alleged contract or transaction concluded beyond the legal capacity of a company should be null and void and cannot be ratified by the unanimous consent of shareholders.[193] The law of agency cannot be invoked to ratify *ultra vires* contracts and transactions as an agent cannot do what his/her principal cannot do.

Likewise, private commercial companies shouldn't be liable for contracts and transactions done beyond its legal capacity. Thus, third parties claim against a company the basis of which is an act done beyond the legal capacity of the concerned company cannot be enforced against it due to; first: the interest of the public- private commercial companies shall not transcend their powers granted to them; second: the interest of shareholders- the capital shall not be exposed to the risks not contemplated in the objects clause; third: the obligation of third parties entering into contract with a company to take notice of the legal limits of its powers.[194]

Invalidation of an act owing to lack of capacity of private commercial companies cause problems to third parties, shareholders and the company. It causes a problem to "third parties who negotiated in good faith with the company" as they would "later find out that they could not enforce the contract because it was invalid."[195] It causes a problem to companies for they cannot enforce *ultra vires* contracts and transactions against their debtors and reclaim their money and thereby would be left barehanded.[196] The company and its shareholders as well as third parties may resort to other options as the effect of *ultra vires* acts of private commercial companies.

4.4.1.2. Legal Effects of *Ultra Vires* Acts of Private Commercial Companies

It has been noted earlier that neither companies nor third parties should be allowed to enforce an act beyond the legal capacity of companies. In effect, the company, its shareholders and third

[193]Ibid

[194]Frank A., 'The Law on Ultra Vires Acts and Contracts of Private Corporations' (1930) 14(4) Marq.LRev. 212,216

[195] CEP (Val) Haynes, T Mugambwa and A Amankwah, (n78), p. 226

[196] Raghvendra Singh and Nidhi Vaidya, (n32)

parties need to resort to other remedies: proceed for personal liability of directors and managers, injunction, tracing and subrogation that are available in commercial regime of different jurisdictions where the doctrine of *ultra vires* is applied on commercial and trading companies.[197]

In Ethiopia, it can be inferred from the provisions of the Com. Code that directors of a company are duty bound to preserve intact the company's assets against misuse and dissipation through channeling it to unauthorized activities due to failure of which they are jointly and severally liable to the company, shareholders and third parties.[198] Moreover, since a manager is an agent of the company s/he is duty bound to undertake activities in the strictest good faith and exclusive interest of the company in compliance with the limits of its objects.[199] Thus, directors and managers that acted in the detriment of a company through wrongful dissipation of its asset due to acts beyond the limits of the company's objects will be held personally liable for breach of duty towards the company and third parties.[200]

In other jurisdictions such as UK and India,[201] injunction, tracing and subrogation are remedies available to third parties and shareholders of a company to proceed against when the company acted *ultra vires* in detriment of their interest. In Ethiopia, however, neither the Com. Code nor the Commercial Registration and Licensing Proclamation provided for the rights of shareholders and third parties to proceed for injunctive order against the private commercial company acting *ultra vires*. Thus, it is unclear whether shareholders and third parties can apply for court order to ban a company from engaging in *ultra vires* activities. Besides, there is no clear legal assurance, under the commercial regime of Ethiopia, for the company creditors to recover their money lent to it by them or products provided by them to the company that acted *ultra vires* to its object. Again, the rights of *ultra vires* lenders of a company whose money is used to pay off lawful debts of the company to step into the position of the debtor paid off and claim his/her/its money to that extent s/he/it would have the right to recover his/her/its loan from the company is not clearly provided under the country's company regime. Thus, it is unclear whether *ultra vires*

[197]These remedies are available to the company, shareholders and non-shareholder stakeholders in UK, India, and Sri Lanka as an effect of the doctrine of ultra vires.

[198] Com. Code, (n14), Arts. 364 (1,2,4), 366 (1,2) and 367

[199] Id, Arts. 348/3 cum 35, 528, CC, (n17), Arts. 2208, 2209

[200] Id, Arts. 530, 348/3 and 35 cum CC, (n17), Art. 2211/2

[201] Raghvendra Singh and Nidhi Vaidya, (n32)

lenders of a company can exercise the right to subrogation and step into the position of the debtor paid off to claim his/her money loaned to the company to the extent s/he would have the right to recover from the company. All these issues relating to *ultra vires* acts of companies are not addressed in the draft commercial code.

4.4.2. Legal Significance of the Doctrine of *Ultra Vires* as Applied to Acts of Directors and Managers of Companies

The power of company directors and managers is "not independent of the company and as a rule they may not carry out, in the name of the company, any activity that the company itself is not entitled to perform."[202] Thus, the authority of company directors and managers needs to be considered in the light of the company's capacity.[203] Moreover, a company constitution defines not only its powers and capacity but also authorities to be delegated to directors and managers.[204] A company's constitution restricts the powers of a company and that of its directors and managers due to which directors and managers have to comply with those restrictions as part of their duties as they can undertake only those activities they are empowered to.[205] Any act of directors and managers beyond their authority, though within the objects clause of the company, is *ultra vires*. So, the security of transactions with a company depends on not only questions relating to the powers and capacity of the company but also the authority of directors and managers.

In Ethiopia, directors and managers of private commercial companies can undertake only those activities conferred on them by the law, company constitutions and resolutions passed at shareholders meetings.[206] They are duty bound to act within powers conferred on them in accordance with the law, company constitutions and resolutions. Accordingly, it is stipulated under Art. 363/1 of the Com. Code that directors of SCs, in acting on behalf of the company,

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[202] John Davies, A guide to directors' responsibilities under the Companies Act 2006, (2007), p. 25 <https://www.google.com/search?q=5.+Davies+J+A+guide+to+directors%E2%80%99+responsibilities+under+the+Companies+Act+2006%2C&oq=5.%09Davies+J+A+guide+to+directors%E2%80%99+responsibilities+under+the+Companies+Act+2006%2C&aqs=chrome..69i57.1334j0j7&sourceid=chrome&ie=UTF-8>

[203] Ibid

[204] Ibid

[205] Ibid

[206] Com. Code, (n14), Arts. 363, 348 (3) cum 35, 528

may only exercise those powers granted to them by the law, the memorandum and articles of association and the resolution passed at shareholders meetings.

Besides, directors of SCs need to observe restrictions imposed on them in carrying out those activities they are authorized to do. Accordingly, it is generally indicated under Arts. 356 and 357 of the Com. Code that a director of a SC should refrain from involving in transactions that could give rise to conflict of interests in breach of his fiduciary duty expected from an agent. Hence, unless authorized by general meetings, directors may not be partners with joint and several liability in rival companies nor compete against the company either on their own behalf or on behalf of third parties.[207] Moreover, any dealings made directly or indirectly between a SC and a director is subjected to prior approval of board of directors and notice to be given to auditors.[208] So, any dealing a director does against the interest of his/her company and with his/her company without and prior approval of board of directors and notice to auditors, respectively, will be *ultra vires* act. Moreover, in principle, directors of a SC other than bodies corporate may not borrow money from the company, obtain an overdraft in current account or have any obligation guaranteed in respect of business transacted with third parties.[209] If a director enters into contract of loan with the SC s/he is running in transgression of the aforementioned statutory restrictions and is *ultra vires*.

Moreover, as it can be inferred from the reading of Arts. 348/3 cum 35 /1& 2/ of the Com. Code, powers of managers of SCs may emanate from the law, company constitutions and resolutions. Hence, while the powers of SC managers to carry out acts of management and those specific acts beyond acts of management are granted by the law, any act beyond the acts of management and those specifically granted by the law is to emanate from the company constitution or resolutions. Likewise, it is implied under Art. 528/1 of the Com. Code that the power of PLC managers emanates from the law. They shall have full powers within the limits of the objects of company. Any restriction to the powers of PLC managers is binding only as between shareholders and managers and shall not bind third parties, though properly published.[210] So, relating to third parties, only the limits of the objects of the company is the limit to the powers of PLC managers

[207] Id, Art. 356

[208]Id, Art. 357

[209] Ibid

[210] Id, Art 528/2

while restrictions, by the articles of association, on the powers of managers must be observed as between shareholders and the managers. Hence, PLC managers may only carry out those activities that are within the limits of objects of the company and restrictions by the articles of association as binding between shareholders and managers. So, any act of PLC managers beyond the objects of the company and in transgression of restrictions thereon is *ultra vires*. Thus, the argument that the commercial regime of Ethiopia has given recognition to the applicability of the doctrine of *ultra vires* to private commercial companies' directors and managers can be substantiated by the aforestated legal analyses.

4.4.2.1. Legal Consequences of *Ultra vires* Acts of Directors and Managers of Private Commercial Companies

As artificial persons, it is a necessity for companies to act through directors and managers delegated with the power to act on behalf of them.[211] It follows that principles of agency law dictates company directors and managers to act only within their authority in binding the company."[212] The company could not be bound by contracts and transactions by directors and managers beyond their authority.[213] They have to act within their authority for outsiders to hold a company bound by a transaction. Any act outside the authority of directors and managers is *ultra vires*. Given that a company couldn't be bound by *ultra vires* acts of directors and managers, the security of transaction entered into with the company will be threatened.[214] As a matter of law, unlike an act is beyond a company's objects clause, "[i]t is open to shareholders of the company in general meeting to ratify" or invalidate acts of directors and managers beyond their authority unless the act itself is fraudulent or constitutes deceitful element.[215] So, any contract or transaction carried out by company directors and managers, unless ratified by shareholders resolution in compliance with prescribed statutory requirements, could be invalidated, *inter alia*, due to lack of authority.[216]

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[211] John Davies, (n203), p.10

[212] Nicholas Bourne, (n43), p.164

[213] Ibid

[214] Ross Grantham, 'The Powers of Company Directors and the Proper Purpose Doctrine' (1994-1995) 5 KCLJ 16

[215] Nicholas Bourne, (n43), p.163

[216] Ross Grantham, (n215), Transactions carried out by company directors may also be invalidated for their act is in breach of their fiduciary duties.

In Ethiopia, it is implied from Arts. 363(2&3), 364/1 and 348/3 cum 35 of the Com. Code that directors and managers of SCs are agents of the company. Likewise, it can be inferred from Arts. 528 and 530 of the Com. Code that managers of PLCs are agents of the company. These agents of private commercial companies are legally empowered to act within the powers bestowed on them by the law, company's constitution and resolutions. So, any act beyond the authority conferred on them is in violation of their duty to act within power.

Unless it is fraudulent or deceitful, the choice is open to the company to ratify or repudiate *ultra vires* acts of its directors and managers. The problem in Ethiopia, however, is that the Com. Code has no explicit provisions as to the power of companies to ratify or invalidate acts of its directors and managers beyond the authority conferred on them. The law slips the possibility of relief for directors and managers from liability through ratification of their *ultra vires* acts and directly inflicted liabilities on them.[217] So, in search of the legal consequences and effects of *ultra vires* acts, it is a necessity to resort to agency law principles to give effect to the mandate of private commercial companies, as a principal, to ratify or repudiate *ultra vires* acts of directors and managers, as agents.

Accordingly, it is stipulated under Art. 2190/1 of the CC that, except mandatory ratification in the interest of third parties in good faith, as stipulated under Art. 2207/1 of the CC, contracts made by an agent in the name of another outside the scope of his power may be ratified or repudiated at the option of the person in whose name the agent acted.[218] Mandatory ratification on the basis of good faith is designed to achieve fairness where formal requirements of acting within authority by directors and managers are not met but they create the impression of authority and third parties are found reasonably rely in good faith on such impression and enter into transaction accordingly.[219] Moreover, a company is required to ratify acts of directors and managers beyond their authority where it is reasonable to admit that, in the circumstances, it would have extended the scope of director's and manager's authority, within its objects, had it been aware of the situation.[220] But, directors and managers may not require the company to ratify an activity they carried out beyond their authority where, before acting, they had the possibility

[217] Com. Code, (n14), Arts. 364-367, 530

[218] CC, (n17), Art 2207

[219] Mads Andenas and F. Wooldridge, (n75), p.319

[220] CC, (n17), Art. 2207/2

of securing authority from the company or where, after having acted, they omitted forthwith to notify the company for ratification.[221] Then, the company shall be deemed to have approved the *ultra vires* acts of directors and managers where, after having received from them or a statement thereupon, it remains silent for a longer period than warranted by the nature of the affair or usage.[222] Again, the company shall ratify their act carried out without authority if its' interest required to do so whereby rights and obligations on the unauthorized act are created from the moment the act was undertaken, i.e. ratification has retrospective effect.[223]

Looking into a company's mandate to ratify, when the transaction in which directors and managers have acted beyond their authority is ratified, it shall be deemed that they have acted within the scope of their power[224] and thereby the company shall be bound by the act and can have the act enforced against third parties and *vice versa*.[225] Ratification has the effect of releasing company directors and managers from personal liability for breach of their duty to act within authority.[226]

However, unlike principals in the ordinary sense of the law of agency, a company has no unfettered power of ratifying *ultra vires* acts of directors and managers. The law grabbed the power of shareholders to ratify acts of directors and managers in breach of their duty to act within the power conferred on them.[227] Accordingly, erring directors and managers of private commercial companies are denied the possibility to escape liability through ratification of their *ultra vires* acts.[228] In effect, creditors are entitled to proceed against directors and managers due to the *ultra vires* acts of whom the company's asset has failed to satisfy their claim, despite their *ultra vires* act is ratified.[229] Again, shareholders and third parties who have been injured by the fault or fraud of directors and mangers acted *ultra vires* may proceed against them to enforce

[221] Id, Art. 2207/3

[222] Id, Art. 2214(1 cum 2)

[223] Id, Arts. 2264/1 and 2265 cum 2192

[224] Id, Art. 2192

[225] Nicholas Bourne, (n43), pp. 227-228

[226] R.T.C Partridge, 'Ratification and the Release of Directors from Personal Liability' (1987) 46(1) C.L.J.122,147

[227] Com. Code, (n14), Art. 460 and 531

[228] Aderonke Abimbola, (n4), p.225

[229] Com. Code, (n14), Art. 356/3, 366

personal liability for claims against the company.[230] Moreover, where the company has repudiated directors' and managers' *ultra vires* act, they will be held personally liable to third parties in good faith.[231] Third parties who failed to inspect the directors and managers authority in registered company documents may not claim against the company, for "since the objects clause appeared in a public document of the company, a third party was in terms of the doctrine of constructive notice deemed to have knowledge of it."[232]

4.4.2.2. Legal Effects of *Ultra Vires* Acts of Company Directors and Managers: Personal Liability to the Company, Shareholders and Non-Shareholder Stakeholders

Both directors and mangers are expected to carry out the affairs of the company entrusted to them within their authority. Directors "owe their company a duty to comply with [the law] and the terms of [company's] constitution, including the limits on their powers, and face personal liability to their company if they fail to do [so]."[233] Accordingly, it is to be inferred from Art. 363 (1,2) of the Com. Code cum Art. 2206/2 of the CC that directors who acted beyond their authority in failure of compliance with, *inter alia*, their duty to act within power shall be jointly and severally liable for damage caused by their *ultra vires* act to the company. In such cases, only directors who can show that they have acted within power may escape from personal liability. That is, only a director who can prove that s/he is not at fault or did not decide to act *ultra vires* the authority conferred on him and has caused a minutes dissenting from *ultra vires* act which has been taken by the board to be entered forthwith in the directors' minutes book and sent to the auditors may escape personal liability.[234] So, only the director concerned shall be held liable to compensate the company for the losses incurred in relation to that director's breach of his/her duty to act within his authority.[235] However, a proceeding against the directors' personal liability to the company for dissipation of its asset in an unauthorized activity may not be

[230] Id, Arts. 367, 460, 530, 531

[231] CC, (n17), Arts. 2193 cum 2194/1

[232] Lindani Baiketlile, (n37)

[233] John De Lacy (Phd) (Ed), *The Reform of United Kingdom Company Law* (Cavendish Publishing Ltd 2002), pp. 102-103

[234]Com. Code, (n14), Art. 364/6

[235] Didas Muganga, 'Corporate Governance and The Liability of Corporate Directors: The Case of Rwanda,' (PhD Dissertation 2016) p. 150

instituted without a resolution of a general meeting to this effect.[236] Thus, a single shareholder may not bring derivative action on behalf of the company and other shareholders against directors acted *ultra vires*. Only the company is empowered to sue directors that acted *ultra vires* and caused dissipation of its asset; our Com. Code follows the 'Real Party in Interest' rule.[237]

Moreover, directors of a SC who are at fault or have been fraudulent through acting beyond their authority will be personally, jointly and severally liable for damage caused to shareholders and third parties.[238] The problem, however, is that the Com. Code, and the draft Commercial Code, follows the 'real party in interest' rule in which case shareholders cannot sue directors for the benefit of the company where it was prejudiced by their *ultra vires* act.[239] Both, shareholders and third parties are required to prove personal damage caused to them by the fault or fraud of directors, *inter alia*, through acts beyond authority.[240] Unless they can prove damage caused, shareholders and third parties are not capable of bringing action against directors that acted *ultra vires*. This prevents them from filing complaints against directors' mismanagement of a company through *ultra vires* acts, to stop them continuing dissipation of the company's asset in unauthorized activities and protect themselves from forthcoming damages. Thus, it seems that directors' liability towards shareholders and third parties as well as effective enforcement of their interest is not given due attention, for liability of directors is subject to proof of damage caused by their *ultra vires* acts.

In other jurisdictions, a derivative action is one of the devised means of protection of the interests of shareholders rather than through the objects clause of the company.[241] Whereas, in Ethiopia, strict compliance with the objects clause of the company that restrict the authority of directors plays pivotal role in making sure that the companies asset is applied for the proper purpose intended by shareholders. So, in the absence of a derivative action by shareholders for damage caused to their company or other shareholders, the complete application of the doctrine

[236] Com. Code, (n14), Art. 365/1

[237] Tan Cheng Han (Ed), *Walter Woon on Company Law* (3rdEd, Sweet & Maxwell 2009), p. 351 (*Emphasis added*)

[238] Com. Code, (n14), Art. 367

[239] Com. Code, (n14), Art. 365/1

[240] Id, Art. 367

[241]Lois M., (n155), p.303

of *ultra vires* on private commercial companies and the management with strict compliance is indispensible for the better protection of shareholders.

Furthermore, pursuant to Art. 366/1 of the Com. Code, SCs directors are liable to creditors when they failed to preserve the company's asset intact, among others, through undertaking only those activities authorized to do so. The liability of director/s is fault-based liability, *inter alia*, due to an *ultra vires* act that caused the dissipation of company's asset and made it insufficient to meet company's debts.[242] Thus, creditors may sue directors who caused the dissipation of company's asset through acts *ultra vires* for the payment of their unsatisfied claims. Moreover, it is to be inferred from Art. 1160/1 of the Com. Code that a director of a SC declared bankrupt, who has carried out commercial operations on his own behalf i.e. *ultra vires* act, which cannot be taken as the act of the company, and disposed of company funds as though they were his own and concealed his activities under the cover of such company may be declared bankrupt and held personally liable towards creditors and third parties. Because, the phrase 'any person' under Art. 1160 (1) of the Com. Code "refers to 'any person' irrespective of whether they are managers, directors or not, regardless of whether they are traders or not.[243]

Regarding managers' liability towards the company, shareholders and non-shareholder stakeholders, the liability of SCs' general managers is not clearly addressed in the Com. Code. Rather, it is to be inferred from the reading of Arts. 348/3 and 35 cum 460 of the Com. Code that general managers of a SC may be liable for an act beyond their authority in respect of the management of the company despite the fact that the balance sheet of the company is approved by the general meeting. Thus, the company, shareholders and non-shareholder stakeholders may proceed against the general manager of a SC for any damage caused by his/her activity beyond the power conferred on him/her by the law and the company's constitution. In contrast, the draft Commercial Code, under Art. 353, has clearly provided the liability of managers to the company, shareholders and third parties for any damage s/he caused by his fault in managing a company.

Furthermore, *ultra vires* acts of PLC managers in default of compliance with their duty to act within their authority under the law and company's constitution will imply personal liability,

[242] Id, Art. 366/2

[243] Endalew Lijalem, (n46), p. 64

individually or jointly and severally to the company and third parties.[244] Thus, the company and third parties are entitled to proceed against PLC managers for any breach of their duties, *inter alia*, to act within the authority conferred on them by the law and company by-laws.

In contrast, there is no clear provision as to the liability of PLC managers to shareholders. Also, shareholders are not allowed to bring suit on behalf of the company for the harm caused to it due to the *ultra vires* acts of managers. Therefore, it can be said that the protection of shareholders interest from *ultra vires* acts of PLC managers is totally left unconsidered, despite the possibility of sustaining damage by them due to such acts. This implies that the Com. Code provisions intended for PLC has totally left out the primacy of shareholders protection who sustained damage due to managers' *ultra vires* acts let alone their right to bring proceeding on behalf of the company and other shareholders. In this respect, Art. 523/1 of the draft Commercial Code has intended to bring better protection to shareholders in clearly spelling out the liability of PLC managers to them; a manager is made personally liable to shareholders for any damage caused due to his act in violation of the law and company's constitution.

An *ultra vires* act of PLC manager that caused the inadequacy of company's asset to pay its debts entails his personal liability, with or without joint liability, to pay the company's debts or part of it to creditors and third parties, upon court order on the application of the trustee in bankruptcy.[245] Also, it is to be inferred from Art. 530 of the Com. Code that PLC managers shall be liable individually or jointly and severally, as the case may be, to, among others, third parties, including creditors, for breach of duty to act within their authority.

Generally, a manger of a private commercial company, declared bankrupt, who has carried out commercial operations on his/her own behalf i.e. *ultra vires* act which cannot be taken as an act of the company, and disposed of company funds as though they were his own and concealed his activities under the cover of such company may be declared bankrupt and held personally liable towards creditors and for third parties claims[246] since, as said before, the phrase 'any person' under Art. 1160 (1) of the Com. Code "refers to 'any person' irrespective of whether they are managers, directors or not.

[244] Com. Code, (n14), Arts. 528 (1.2) cum 530

[245] Id, Art. 531

[246] Id, Art. 1160

CHAPTER FIVE

5. Conclusion and Recommendations

The doctrine of *ultra vires*, in the context of companies, means acting beyond the power and capacity of a company and the authority conferred on its agents- directors and managers. The foundation for the applicability of the doctrine on companies is the objects clause stated under their memoranda while the law, companies' constitutions and resolutions are the basis for its applicability regarding company agents.

The doctrine of *ultra vires* applicable on private commercial companies was a judge made rule. It was first introduced in England and developed in other common law and civil law jurisdictions to protect company creditors following the introduction of the principle of limited liability that restrain them from proceeding against shareholders for the payment of their claims against the company. Also, the application of the doctrine on a private commercial company that restrain it and its management to its objects in employing shareholders money is said to have the aim of shareholders protection. It is also argued that the applicability of the doctrine on private commercial companies contributes for the advancement of countries' economy and helps the government in disciplining companies and their management.

The doctrine of *ultra vires* is still existent in the commercial regime of different jurisdictions, civil and common law, despite criticisms for its harsh effect on third parties in good faith. True, the tendency in common law countries is towards the abolishment of the doctrine in favor of giving companies the power and capacity of natural persons as seen in American company regime. Whereas, it is still operative in most civil law jurisdictions as their company regime requires companies to include their objects clause in their memoranda. Indeed, the doctrine of *ultra vires* is not operative in some civil law jurisdictions like Germany as its company regime doesn't require companies to include objects in their memoranda.

In Ethiopia, the required inclusion of company's objects clause in its memoranda, failure of which could entail the dissolution of the company and such provisional measures as may be necessary, and restraints on the authority of company directors and managers and consequence of failure to comply such limits emphasizes the legal significance given to the applicability of the doctrine of *ultra vires* on private commercial companies. Moreover, the stringent requirements set for the amendment of objects clause creates favorable conditions to argue that the commercial

regime of Ethiopia has given a legal cognizance to the applicability of the doctrine of *ultra vires* on these companies.

With underdeveloped culture of incorporation in Ethiopia, the doctrine of *ultra vires* plays a pivotal role in disciplining companies through confining them to objects stated in their memoranda and enable new companies to flourish thereby culture of incorporation enhanced. The problem, however, is that the doctrine of *ultra vires* is not adopted in its complete sense as the fate of *ultra vires* acts of companies and their agents is not clearly defined. This legal gap compels us to resort to the general principles of law and rules in the law of agency to explore the consequences of *ultra vires* acts of companies and their agents. Such absence of clear rule on the subject would result in commercial uncertainty on the part of shareholders and non-shareholder stakeholders of companies.

Moreover, the country's commercial regime is to be impugned for its failure to have sufficiently defined the liability of company agents for their *ultra vires* acts and guarantee the interest of minority shareholders dissented to the majority's decision to amend company's objects, due to legal and practical loopholes. Therefore, owing to such gaps and on the basis of the findings of this study on the legal significance of the applicability of the doctrine of *ultra vires* on private commercial companies in Ethiopia, the following recommendations are forwarded.

1. The scrutiny on the commercial regime of the country denotes that the doctrine of *ultra vires* is given a legal cognizance. However, the rule can be said effective if it provided for the fate of *ultra vires* contracts and transactions which is lacking in the current company regime of Ethiopia. Therefore, it is recommended that the legislature shall come up with clear rules that define the fate of *ultra vires* contracts and transactions, striking the balance between the interests of different stakeholders of a company.
2. In addition to proceedings against directors and managers to make them personally liable, it is also recommended that the forthcoming amendment on the Com. Code shall empower shareholders and non-shareholder stakeholders, though they might not sustain damage, to bring action to ban companies and their agents from continuing dissipation of companies' asset in unauthorized activities and to get their money through means of tracing and subrogation.

3. As knowing the average price of shares, in SCs, is difficult in the absence of a stock market established in the country and the law being silent on the exit right of minority shareholders of PLCs that dissented the majority shareholders decision to amend company's object, it is recommended that the government shall establish a stock market and the legislature to guarantee exit right of minority shareholders of PLCs.
4. Again, it is recommended that the forthcoming amendment of the Com. Code shall provide for the consequences of undesirable outcomes of investigation by MoTI which may ensued from, *inter alia*, *ultra vires* acts of SCs and their agents.
5. It is recommended that the liability of general managers of SCs, for, *inter alia*, their *ultra vires* acts, to the company, shareholders and third parties provided under Art. 353 of the draft Commercial Code, but lacking in the existing Com. Code, shall be retained in the forthcoming Com. Code.
6. It is recommended that the liability of PLC managers, for, *inter alia*, their *ultra vires* acts to shareholders, which is not provided in the existing Com. Code, shall be retained included in the upcoming Com. Code.
7. It is also recommended that the commercial regime of the country shall have to make a paradigm shift from following 'real party in interest' rule to allowing shareholders to bring suit on behalf of the company for the harm caused to it due to the *ultra vires* acts of company directors and managers for the better protection of shareholders and ensuring compliance of companies in undertaking only those businesses they are authorized to carry out.

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