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The Doctrine of Ultra Vires in North Carolina

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The importance of corporations in the modern world of business can hardly be exaggerated. These great artificial entities, reaching out and entering into the intricacies of our daily existence, constitute a medium for the transaction of a major share of the Nation's business. Hence it becomes a matter of utmost importance to ascertain the scope of powers given to ordinary business corporations, and to consider the effect of their exceeding this authority.

I. The Common Law

In England in the seventeenth century, Sutton's Hospital Case recognized the capacity of a corporation to do any act which could be done by an individual. Later, with respect to corporations created by parliamentary charter or under a general corporation act, this theory of corporate capacity was superseded in England by the adoption of a theory of limited capacity or special powers. According to this theory, a contract which is ultra vires, that is, beyond the powers outlined in the purpose clause of the charter or articles of incorporation, is void and cannot be used as the basis for an action. This extreme view was introduced into American Law, and is still recognized by the United States Supreme Court and the courts of Alabama, Maine, Massachusetts, Tennessee, and perhaps Maryland, although usually in a somewhat modified form.

The United States Supreme Court, while adhering to the basic proposition that such a contract was void, soon found that in order to...
reach just results it was forced to hand down decisions which were irreconcilable with that doctrine.\textsuperscript{10} Out of the confusion, however, have come at least two cardinal principles. (1) Although a wholly executory \textit{ultra vires} contract is not enforceable,\textsuperscript{11} the Court will not disturb the status acquired under such a contract when the agreement is fully executed on both sides.\textsuperscript{12} This holding has been criticized as being clearly inconsistent with the original theory, in that, the contract being void, neither party could possibly acquire any rights under it—\textit{the whole transaction should be set aside, rather than to allow it to remain performed.} (2) However, the fact that a part of the contract was executed would not affect the law as to the executory portion.\textsuperscript{14} In this situation the party who has performed on the faith of the existence of the contract will be permitted to recover the value of his performance in an appropriate action sounding in quasi contract.\textsuperscript{15}

Most state courts, even in the absence of remedial legislation, treat the \textit{ultra vires} transaction more liberally. They follow the Federal view if the contract is either wholly executory or wholly executed; but depart from it by holding that if the contract is executed on one side only, the party who has performed is permitted to base an action on the contract itself. Under this doctrine, based either upon a theory of an unfair

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acceptance of benefits or upon an abortive theory of estoppel, the opposing party is not permitted to set up the plea of ultra vires. Some states, however, including North Carolina, allow an action based either upon the contract or on quasi-contractual principles.

Only one state has announced a broader rule without a resort to remedial legislation. The Kansas Court has declared that even an executory ultra vires contract is enforceable. "The state grants the corporation the right to do business under limitations expressed in language to which both agree. Whether the language of the charter shall be interpreted to authorize a given act is a matter between the parties to it. If the state is satisfied with the construction upon which the corporation acts, no reason is apparent why it should be open to question by a stranger, much less by one who has recognized it as valid by contracting with the corporation upon that basis." This court believes that to allow the defense of ultra vires to be used by the corporation or by a private person "as a means of obtaining or retaining something of value which belongs to another, would be to turn an instrument intended to affect justice between the state and corporations into one of fraud as between the latter and innocent parties. . . . The doctrine that only the state can challenge the validity of acts done under color of a corporate charter, if accepted, must necessarily protect an executory contract from collateral attack, equally with one that has been executed."

In North Carolina, rules governing the scope of corporate powers have developed alongside the rise of corporations to their present importance. The state court has declared that a corporation may exercise only those powers, expressed or implied, which are granted to it by the general corporation law and by its charter or articles of incorporation. Powers conferred by charter are always strictly construed, and per-
sons dealing with corporations are chargeable with constructive notice of the limitations and restrictions contained therein, as well as with notice of statutory limitations and restrictions. As a whole, the North Carolina law is somewhat clearer than is that of the Federal Courts, the state court explaining its position quite lucidly in most instances, and making only an occasional mistake in terminology.

To summarize the North Carolina law: There is an intimation in one opinion that an ultra vires contract which is wholly executory on both sides cannot be enforced by either party. When the contract has been performed on one side, however, the court has held that it is enforceable against the corporation, and the natural supposition is that it would likewise be enforceable against the party to whom the corporation has become obligated. There are decisions which base this right of recovery upon the doctrine of estoppel.


22 Peoples' Nat. Bank v. Southern States Finance Co., 192 N. C. 69, 133 S. E. 415 (1926). In Sherrill v. Am. Trust Co., 176 N. C. 591, 97 S. E. 471 (1918), it is said, however, that a corporation would not be permitted to set up a plea of ultra vires against a holder, otherwise bona fide, of a negotiable instrument if the transaction was not such as to give the holder notice that the corporation had exceeded its powers in making the instrument. And in Luttrell v. Martin and The Piedmont Lumber, R. & M. Co., 112 N. C. 594, 17 S. E. 573 (1893), the court made a point of the fact that the person who dealt with the corporation neither knew nor could be expected to know that the contract was one which the company was not authorized to make.


24 The term "ultra vires" has been used somewhat indiscriminately in the North Carolina decisions. It has been employed to describe transactions which were decided on the ground that a corporate agent had no authority to transact the business in question. Merchants' Nat. Bank v. Dunn Oil Mill Co., 157 N. C. 302, 73 S. E. 93 (1911); Pinchback v. Bessemer Mining Co., 117 N. C. 484, 23 S. E. 425 (1895). The term was used in one case to describe a transaction which was violative of the by-laws, Phillips v. Interstate Land Co., 176 N. C. 514, 97 S. E. 417 (1918), and in another to indicate a contract which was void because of a former statute of frauds applicable to corporate contracts. Clowe v. Imperial Pine Product Co., 114 N. C. 304, 19 S. E. 153 (1894).


28 Bank of Canton v. Clark, 198 N. C. 169, 151 S. E. 102 (1929); Hutchins v. Planters' Nat. Bank, 128 N. C. 72, 38 S. E. 252 (1901). See Trustees of Charlotte Township v. Piedmont Realty Co., 134 N. C. 41, 46 S. E. 723 (1903). The estoppel rule applies only when a party has received benefits. In Brinson v. Mill Supply Co., 219 N. C. 498, 14 S. E. (2d) 505 (1941), the corporation, not being authorized to enter into a contract for the accommodation of another, made an agreement of this nature by guaranteeing the payment of the personal note of its president. Since the corporation received no benefits, however, it was held that its receiver properly rejected a claim based on the contract for the reason that the agreement was ultra vires. See also Brinson v. Mill Supply Co., 219 N. C. 505, 14 S. E. (2d) 509 (1941). The case of Sears, Roebuck & Co. v. Rouse Banking Co., 191 N. C. 500, 132 S. E. 468 (1926), involved a special deposit with a bank for
In this connection, it is helpful to consider a statute of frauds which at one time existed in North Carolina, requiring all corporate contracts of an amount exceeding one hundred dollars to be in writing. The doctrines therein applied to parol corporate contracts over that value were practically the same as those presently applied to ultra vires contracts. Under that statute it was held that if the contract was entirely executory, no action could be predicated thereupon by either party; that if the contract was one which had been performed by one party, it could be enforced against the other either by an action on the contract or in an action based on quasi contractual principles; but that if the contract was only partially performed by such a person, he could recover upon the executed portions only and would not be permitted to enforce that part which was executory.

In respect to ultra vires conveyances, the law is definitely settled that the State is the only party that can object to a corporation exceeding its actual authority in acquiring real property.

On the other hand, North Carolina clearly recognizes the stockholder’s right to prevent ultra vires diversion of corporate funds. In a much discussed decision, it was held that a textile corporation had no power to insure the life of one of its officers for the benefit of the company. The Court, declaring that such a diversion of the corporation’s funds could be prevented at the suit of a stockholder, enjoined payment of all future premiums on the policy. The decision was limited in scope to that portion of the contract which was executory. In addition, be emphasized that in order to invoke this sort of remedy, the purpose of paying a debt contracted by the depositor, and the bank having permitted him to withdraw the funds, the relationship was held to be one of trust. In this instance it was held that the bank could not successfully make a plea of ultra vires in an action by the depositor’s creditor for the breach of trust in allowing the withdrawal.

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29 N. C. Code (1883) §683. This statute was repealed in 1893 (N. C. Pub. Laws 1893, c. 84), but not before numerous cases had been decided under its provisions.


34 Victor v. Louise Cotton Mills et al., 148 N. C. 107, 61 S. E. 648 (1908). This decision was evidently unpopular, for a statute was soon afterwards enacted which gave corporations express power to insure the lives of their officers. N. C. Code Ann. (Michie, 1939) §1126, ss.5.
stockholder must act promptly and follow up his objection by "active and preventive means"; for if he does not do this but rather waits until the opposing party has changed his position, he will not then be permitted to enjoin or defeat the contract by showing that it was *ultra vires*.36

Another opinion intimates that an *ultra vires* contract made by corporate agents in excess of their real or apparent authority is not capable of being ratified by proper corporate action;37 but this probably does not mean that such a contract, if properly ratified, would not be governed by the same principles of law as the usual *ultra vires* transaction.

In the situation, however, where a corporate body undertakes to perform an act which is foreign to the purposes expressed in its charter or articles of incorporation, and in doing that unauthorized act injures someone, the North Carolina Court follows the generally expressed rule and forbids the corporation to set up *ultra vires* as a defense in the consequent tort action for damages.38

II. CRITICISM OF THE THEORETICAL BASES FOR THE
DOCTRINE OF ULTRA VIRES

After this review of the existent law in North Carolina, the question arises as to what, if anything, should be done in order to obtain the best possible solution of the difficulties therein presented.

One of the most learned authorities on this subject, Professor Carpenter, has enumerated and criticized the grounds advanced by various courts for upholding the doctrine of *ultra vires*, analyzing them in the following manner:39

(1) The doctrine of limited capacity, (2) constructive notice of charter limitations, (3) illegality of contract, (4) public policy, (5) violation of the rights of *intra vires* creditors, (6) violation of the rights of innocent stockholders. A survey of the reasoning advanced with respect to each one of these propositions40 is desirable at this point in order that we may obtain a more thorough understanding of the problems involved:

(1) The objections raised with respect to the theory of limited capacity or special powers are, (a) that it will not explain all of the decisions in any one jurisdiction, (b) that it does not portray the true

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40 Professor Carpenter also criticizes the theory of estoppel by receiving benefits of an *ultra vires* contract. He believes that there is no true basis for estoppel, since entering into the agreement affords as much ground for estoppel as accepting its benefits.
nature of the modern corporation, and (c) that unjust consequences have often resulted from its application. Professor Carpenter points out that at the present time, the incorporators instead of the State prepare the articles of incorporation. Accordingly he believes that the concept of the corporation as a group of persons acting as a legal unit is the true one, since this theory avoids unjust results and allows the courts much more flexibility in treating the problem. Therefore he advocates the complete scrapping of the doctrine of special powers and an adoption of the early English theory of general powers, i.e., that the corporation is capable of performing any act which may be performed by the individual. Under this theory the corporation is still not authorized to do anything which is contrary to its charter powers, express or implied; but it must be kept in mind that there is a distinction between capacity and authority.

(2) He declares that in view of the numerous and often complicated charter provisions of the modern corporation, it is unreasonable to charge those dealing with the corporate entity with constructive notice thereof. Certainly one could scarcely be expected to have knowledge of the charter provisions of every corporation with which he deals, especially in view of the inaccessibility of corporate records to persons who are travelling from one place to another or who live at a distance from the place where the records are kept. He compares this doctrine with the one which obtains in partnership law, and declares that the rule of pure agency law should be adopted with respect to corporations. The agency rule here mentioned is the usual rule of agency law which makes a contract enforceable where it is made with an agent who has apparent authority to enter into the agreement, irrespective of the lack of actual authority in the agent. Hence he advocates the complete abandonment of the doctrine of constructive notice.

(3) As Mr. Carpenter recognizes, an *ultra vires* contract is certainly illegal in one sense of the term, since it is unlawful for a corporation to exceed the powers granted by its charter or articles of incorporation; however, he points out that the consequences of a violation of these provisions should not be the same as the consequences of a transaction which is contrary to the public welfare or one which is prohibited by statute. The rationale is that the *ultra vires* contract is not truly illegal in the sense of being *contra bonos mores*, but is only one which the corporation is unauthorized to make.

(4) Furthermore, he does not believe that public policy demands that a contract made by a corporation in excess of its charter powers be treated as void or inactionable. If the contract, besides being *ultra vires*, is undesirable for some other reason, it should be declared illegal for
that reason and not on the ground that it is unauthorized by the corporate articles.

(5) It is Mr. Carpenter's view that unless the security on which the *intra vires* creditor depends is endangered in some manner by the *ultra vires* transaction, he should not be allowed to interfere—his interest is said to be insufficient. Furthermore even if the security is in danger of impairment, the creditor should be protected, if at all, by legal principles other than the doctrine of *ultra vires*.

(6) He evidently believes that a stockholder should be granted an injunction to prevent corporate officials from entering into *ultra vires* transactions, and that, if such a contract has already been entered into, the stockholder should be allowed to recover resulting damages from the officers and directors. Moreover, if the contract has been made, the aforementioned principles of agency law should govern its validity as to third parties.

The objections which Professor Carpenter makes to the theory of limited capacity had been expressed much earlier by other writers. One commentator stressed the fact that since corporate charters are now prepared by the incorporators themselves under general laws instead of by the legislators, the importance of the doctrine of limited capacity is no longer existent, but rather that there is now a need of reviving the older doctrine. Professor Pepper, in 1898, argued in favor of such a revival, saying: "We shall never see our commercial law in a satisfactory state until the courts re-establish the common law doctrine of general capacities, treating contracts made beyond the limits of chartered activities as contracts prohibited but not void—and leave the state to punish the disregard of the prohibition, while enforcing the contract between the parties."42

Another recognized authority on this subject, Professor Stevens,43 advocating in substance the adoption of the foregoing principles, proposes that the doctrines of limited capacity and constructive notice be abolished by statute, and that the course be left free to settle individual cases involving other diverse interests. Such a rule would facilitate flexibility. He further declares that the enforceability of all purely *ultra vires* contracts, whether partially executed or wholly executed, or executory, should be governed by certain general rules of agency law, whereby the results would be as follows: The stockholder would be protected in proper cases, but not when such protection would lead to unjust consequences for the party dealing with the corporation. A corporation

42 Pepper, Rights Under Unauthorized Corporate Contracts (1898) 8 YALE L. J. 24, 31.
43 Stevens, A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine (1927) 36 YALE L. J. 297.
should be permitted to defend itself by a plea of *ultra vires* only as against one who, as a prudent man, could and should, or did ascertain the officers' true authority. In other words, he desires to place the articles of incorporation on the same basis as the by-laws.

### III. Statutory Enactments and Criticisms

The general theory of Carpenter and Stevens seems to have been embodied in the Uniform Business Corporations Act, wherein the doctrines of limited capacity and constructive notice are abolished and the courts left free to work out proper and equitable rules in dealing with problems as they present themselves. Thus in states adopting the Uniform Act, we see a return to the old common law doctrine of general capacity as a result of modern conditions. Professor Ballantine criticizes this statute, declaring that the "draftsman has failed to indicate clearly what legal consequences he desired to bring about, but has simply thrown out a vague direction to courts now hopelessly at sea to swim to shore through the fog by juggling the words 'capacity' and 'authority' as best they can."46

Provisions similar to those adopted by the Commission on Uniform Laws have been inserted in the modern Ohio Corporations Act, wherein it is provided that "no limitation on the exercise of the authority of the corporation shall be asserted in any action between the corporation and any person, except on behalf of the corporation against a director or an officer or a person having actual knowledge of such limitation." Moreover, "the articles of incorporation shall constitute an agreement by the director and the officers with the corporation that they will confine the acts of the corporation to those acts which are authorized in the statement of purposes." Provisions similar to these have been enacted in Michigan and Minnesota. Professor Stevens, commenting on this statute, has said that the latter provision should not, and probably will not, be construed as a guaranty that the management will not enter into such a transaction, and that officials should only be held liable when they have been negligent in not ascertaining whether a particular transaction was permissible. The first provision, allowing the plea of *ultra vires* where a person has actual knowledge of the corporation's lack of authority, meets with his approval; but he advocates its extension to include

"Uniform Business Corporations Act, §§10, 11. The Model Act approved by the Commissioners has been adopted in Idaho, Louisiana and Washington. 9 U. L. A. 71 (1941)."

44 Ballantine, *Questions of Policy in Drafting a Modern Corporation Law* (1931) 19 CALIF. L. REV. 465, 473.
instances where a reasonably prudent man should have ascertained the true nature of the corporate powers. Professor Stevens also points out and approves of the fact that a statute of this type does not interfere with the privilege of courts of equity to grant or withhold the extraordinary remedy of specific performance. He believes that equity can be trusted to withhold this remedy in instances where the granting of the relief would lead to inequitable results.

Another eminent authority, Professor Ballantine, argues that the Ohio rule does not sufficiently protect persons dealing with corporations, in that consultation of an attorney would be necessary before any such person could act in safety. He declares that there is no halfway remedy, and urges that "the defense of ultra vires must be abolished as between the corporation and third parties," whether or not they have actual notice of charter limitations. He further states that the abolition of the defense of ultra vires should not be used to shield those who were guilty of actual fraud or conspiracy in inducing the directors or officers to enter into an unauthorized contract. In such a situation the corporation should be permitted to plead this fraudulent conduct as a defense.

Professor Ballantine's ideas are incorporated in the California statute upon this subject, which provides that no limitation contained in the corporate articles shall be asserted in any action between the corporation or its stockholders, and a third party. Such provisions, in that case, actually limit the authority of the corporate representatives only in actions by the State, or actions by shareholders to enjoin the carrying on or continuation of unauthorized business—which latter action is maintainable only when third parties have acquired no rights in such contracts. Accordingly, under that statute unauthorized contracts or conveyances would seem to bind both parties, whether executed, or wholly or in part executory.

The most radical assertion of this idea is found in the Vermont statute, which wholly abolishes the defense of ultra vires by providing that any otherwise unlawful act of corporate directors shall "be re-

60 For expressions of approval of the provisions of the Ohio act as being in accord with the ordinary rules of agency law, see Notes (1932) 39 W. Va. L. Q. 64; (1927) 27 Col. L. Rev. 594. See also Warren, Executory Ultra Vires Transactions (1911) 24 Harv. L. Rev. 534.

61 Ballantine, Question of Policy in Drafting a Modern Corporation Law (1931) 19 Calif. L. Rev. 465. Formerly he seems to have taken the view that the rules of agency should govern. Cf. Ballantine, Proposed Revision of the Ultra Vires Doctrine (1927) 12 Corn. L. Q. 453.

62 Ballantine, Questions of Policy in Drafting a Modern Corporations Law (1931) 19 Calif. L. Rev. 465, 474.

63 Ballantine, Changes in the California Corporation Law (1929) 17 Calif. L. Rev. 529, 533.

64 Civ. Code of Cal. (Deering, 1937) §345.

garded as the act of the corporation, and the corporation shall be liable therefor, even if such act was not necessary or proper to accomplish its purposes, to the same extent that it would have been liable for such act had it been necessary or proper to accomplish its purposes."

On the other hand, Professor Ballantine's theory has been adopted to a lesser extent in the statutes of Illinois and Pennsylvania. Both statutes provide that no limitation, expressed or implied, in the articles of incorporation "shall be asserted in order to defend any action at law or in equity between the corporation and a third person, or between a shareholder and a third person, involving any contract to which the corporation is a party or any right of property or any alleged liability of whatsoever nature." However, it is provided that such a limitation may be asserted (a) by the state in an action to dissolve the corporation or to enjoin it from the transaction of unauthorized business, (b) in an action by a shareholder in a representative suit against the officers or directors for exceeding the charter powers, or (c) in any action by a shareholder against the corporation to enjoin the transaction or continuation of unauthorized business. In regard to the third type of action, it is provided that the court may, if it is deemed equitable, set aside and enjoin the performance of the contract, allowing the injured party compensation for damages sustained. However, it is also provided that anticipated profits to be derived from the performance of the contract shall not be considered a proper element of damages.

This injunction provision, seeming to give courts of equity wide discretion in handling cases as they arise, has been criticized by Professor Ballantine on the ground that it would allow the corporation to avoid a disadvantageous contract by inducing one of its stockholders to bring proceedings for an injunction. It is believed, however, that this criticism is not merited, for such an interpretation of the statute would leave the law practically as it was before its enactment. Hence it is doubtful that the courts would allow a shareholder an injunction against the performance of a contract when such a judgment would be unfair to third parties. Another writer suggests that the problem would be greatly simplified if the injunction provision was construed to be applicable only to future unauthorized contracts, but doubts that the provision was intended so to be interpreted. He further states that if that is not the proper interpretation, the courts are left in a state of confusion as to the applicability of this remedy.  

57 PENNA. STAT. ANNO. (Purdon, 1938) tit. 15, §§2852-9, 2852-301, 2852-303.  
60 Note (1930) 44 HARV. L. REV. 280.
It is somewhat doubtful, however, whether the interest of the party dealing with the corporation is sufficiently protected by this type of statute, in view of its provision negating anticipated profits as damages. This clause was evidently inserted as a protection against the nefarious schemes of persons who seek to draw the corporation into so-called “wildcat” enterprises. However, as the provision is now worded, it might easily be employed to defeat recovery of legitimate profits anticipated from transactions into which third parties entered innocently. Would not the interests of all concerned be better served by the application of the ordinary rules of agency law to this type of statute?

It is further recognized that the Illinois Act makes no mention of the abrogation of the doctrine of constructive notice, as has been done in most of the modern statutes above mentioned. It has been said by one writer that if the Illinois court decided that that doctrine was still in effect, many former evils of ultra vires would reappear. However, that writer does not believe that the courts would consider constructive notice to be such an equitable principle as would warrant the courts in setting aside or enjoining an unauthorized contract in the face of the statute.61

In spite of these objections, the injunction provisions of the Illinois Act are decidedly worth-while. Removal of the stated objections, however, would serve to prevent many otherwise possible injustices.

With all of these developments, the doctrine of ultra vires as propounded by the great majority of courts in this country is still not satisfactory. Even the majority rule, refusing to enforce executory contracts, fails to meet the situation adequately. It has been said that our courts are tending to encourage rather than discourage ultra vires acts on the part of the corporate officers.62 That is, the corporate agents or third parties may have known at the time the contract was made that the transaction was unauthorized, and have intended to perform only if carrying out the agreement developed a profit instead of a loss. Thus, an intentional beforehand consideration of the defense of ultra vires may often result in the forces of law aiding a premeditatedly guilty party in depriving innocent persons of profits of business to which they otherwise would have been entitled.

IV. Conclusion

Granting that the ultra vires doctrine as thus applied is outmoded, just what are we to do in attempting to modernize the law in this respect? How and by what methods are we to protect to the best advantage the various interests involved? As those attempting to formulate statutes have found, the problem is not an easy one.

On the whole, the general principles advocated by Carpenter and

61 Note (1935) 29 Ill. L. Rev. 1075.
Stevens and their school of thought seem to offer the best solution. However, while their analogy to the familiar principles of agency law presents an easy and sensible way out of the difficulty, it gives questionable results in at least one aspect. That is, while we are willing to follow the analogy to the extent of allowing the corporation to avoid liability on an unauthorized contract where the other party actually knew that the transaction was in excess of the charter powers, we do not believe that this proposition should be extended to include those situations where a person is merely negligent in not ascertaining that the contract was unauthorized. Such a rule would be difficult to administer, and might be employed to lessen benefits to be gained from the abolishment of the doctrine of constructive notice. If such a rule were followed, just where would the duty of the party dealing with the corporation end? Would he be required to inquire into the actual authority of the corporation in order not to be negligent? If so, just how far would he be required to go in his investigation? If to the charter, the new rule is the equivalent of the old. Of course such a rule might prevent injustice to non-assenting minority stockholders, but such cases would be exceptional, and would not warrant the adoption of a rule so difficult to apply. On the other hand, without such a rule, cases might well arise in which the negligence was so gross that to permit recovery would be unjustifiable. Yet, some workable rule must be adopted, even though it be a compromise between good and bad results. This consideration was evidently uppermost in the minds of those who drafted the statutes of Michigan, Minnesota and Ohio, which deny recovery only to those who have actual notice of lack of authorization.

And here may be pointed out an admirable feature of the Uniform Act. By merely pruning off the objectionable doctrines of limited capacity and constructive notice, the Uniform Act has left the courts free to adopt general rules of law with respect to unauthorized contracts. Thus, under this type of statute, exceptions may be made with much greater facility than under statutes which attempt to go further and describe and delimit rights acquirable under such unauthorized agreements.

Nevertheless, the advantages and disadvantages of both of the preceding methods are apparent, in that while the Uniform Act is conveniently vague, it discourages rigidity, and while the more detailed statutes are sufficiently rigid, they are not sufficiently elastic to provide for exceptional cases.63

Another situation calling for examination in view of possible revision of our laws is where the corporate officials enter an agreement, knowing at the time that it is unauthorized. Clearly the party dealing with the

corporation ought to be permitted to maintain an action, but should the corporation be allowed to sue? Are we going to permit the corporate body to enforce a contract which its chosen representatives knew to be in excess of the charter powers, when such relief is denied where the third party had such knowledge and the corporate officers did not?04

The Michigan, Minnesota and Ohio statutes appear to answer this query in the affirmative. And this view would seem to follow the agency analogy, since the general rule of the law of principal and agent is that the agent's knowledge is imputed to the principal only when the former is acting within the scope of his agency.85

On the other hand, it will be remembered that Ballantine's solution would prevent the plea of ultra vires in any such suit between the corporation and third parties dealing with it. This view seems to go too far in protecting those who knowingly transact unauthorized business with the corporation; for, under this theory, with the collusive aid of officers of the body, third persons could easily take advantage of shareholders by entering into contracts which they knew were unauthorized, and the stockholders would necessarily have to prove affirmative fraud in order to avoid the agreement. While it is true that the shareholders would yet have recourse over against the officials responsible, insolvency of such officials and the difficulties inherent in such litigation66 might well make this remedy inadequate. Consequently, the shareholders must be protected from such chicanery, in spite of the fact that their chosen representatives also knew that the transaction was unauthorized.

Something of this sort was evidently in the minds of those who drafted the Illinois and Pennsylvania statutes. The above-mentioned injunction provision, contained in both of these acts, seems to be a definite effort to protect the stockholders from such machinations as those just described. According to these statutes, the court may set aside or enjoin the further performance of any unauthorized contract at the request of a shareholder, provided the court deems such action equitable, and further provided the court shall allow compensation for the damages which may result from its action.

However, as was seen above, in the Illinois and Pennsylvania statutes a provision is added that anticipated profits are not to be awarded as loss or damages sustained. The desirability of this clause may well be questioned. While one of its purposes evidently was to protect shareholders from being penalized too greatly by the assessment of damages of a nebulous character, the provision may be employed to defeat one of the chief purposes behind the statute. An example will

64 A fortiori, if both parties had such knowledge, the contract should be enforceable.

65 Tiffany, Law of Principal and Agent (2d ed. 1924) §108, p. 294; Mecham, Agency (3d ed. 1923) §486; Restatement, Agency (1933) §§272, 273.

serve to illustrate this weakness: The directors of a corporation make an unauthorized contract wherein the profits are largely anticipatory, but discover before performance that the transaction will result in loss to the corporation. Immediately they seek a way out of a bad bargain, and their legal department advises them that, the contract being unauthorized, this injunction proceeding could be used to forestall a suit on the contract by the other party. Using some shareholder as a dummy, injunction proceedings are instituted. This action is ostensibly taken to halt performance on the unauthorized contract; in reality it is brought for the purpose of bringing the case within the statute and thus escaping the payment of the anticipated loss as an element of damages in the suit by the opposing party which would follow a refusal to perform the contract. Thus by such procedure the very purpose for which the statute was enacted, namely, the abrogation of the defense of *ultra vires* in actions between corporations and parties who have dealt with them, would be circumvented. On the other hand, if anticipatory damages were not expressly disallowed, this result would not follow, and where sufficiently ascertainable, such profits would constitute a proper element of damages—thus further liberalizing the rule. A thorough consideration of all the interests involved is recommended prior to the inclusion of such a clause in any proposed revisal of the North Carolina law in this respect.

As mentioned above, some states which have made statutory changes in respect to the problem of *ultra vires* contracts have extended the doctrines so enacted to contracts and conveyances made by foreign corporations. Such an extension is to be commended, and might well be followed in any attempt to clarify and modernize the corporation laws.

The changes advocated above would make comparatively few alterations in the law of North Carolina as it is today. The doctrines of limited capacity and constructive notice would be abrogated, but there seems no doubt that such action would merely serve to enact substantially the present judicially created rule with the exception of executory contracts which would then become enforceable, whereas at present it seems likely that they are not. Furthermore, by such a revision the interest of stockholders would be protected in all cases except those where such action would entail an unfair loss to innocent parties. On the other hand, the defense of no agency, as distinguished from that of *ultra vires*, would still be available, thereby allowing the corporation to avoid contracts which were within neither the actual nor the apparent authority of its directors or officers.

It is recommended that the attention of the North Carolina General Assembly be called to the changes needed in the corporation law of the State in this respect. It is hoped that the discussion of principles herein set forth will be of some value in the enactment of remedial legislation.

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