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Ultra Vires Acts in Indiana

CORPORATIONS

ULTRA VIRES ACTS IN INDIANA

The Indiana General Corporation Act provides: "Each corporation shall have the *capacity* possessed by natural persons, but shall have *authority* to perform only such acts as are necessary, convenient

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of the sale and manufacture of alcoholic beverages. Handler v. Peter Doelger Brewing Corp., 173 Misc. 173, 17 N. Y. S. (2d) 275 (Sup. Ct. 1940).

[7] Romano v. Bono, 6 N. Y. S. (2d) 204 (1938); RESTATEMENT, CONTRACTS (1932) § 580.

[8] Pelosi v. Bugbee, 271 Mass, 579, 105 N. E. 222 (1914).

[9] Matsa v. Katsoulas, 192 Wis. 212, 212 N. W. 261 (1927).

[10] Martin v. Hodge, 47 Ark. 378, 1 S. W. 694 (1886).

[11] Duffy v. Gorman, 64 Mass. 45, (1852); Funk v. Gallivan, 49 Conn. 124, (1881); *cf.* Dwight v. Brewster, 18 Mass. 50 (1822).

[12] Myers v. Meinrath, 101 Mass. 366 (1869); Parker v. Latner, 60 Me. 528 (1872); Woodman v. Hubbard, 25 N. H. 67 (1852); *cf.* Stewart v. Davis, 31 Ark. 518 (1876); Hall v. Corcoran, 107 Mass. 251 (1871).

[13] Holman v. Johnson, 98 Eng. Rep. 1120 (K. B. 1775).

[14] Rosasco Creameries v. Cohen, 276 N. Y. 234, 11 N. E. (2d) 908 (1937).

[15] Armstrong v. Toler, 11 Wheat. 258 (U. S. 1826).

[16] Gellhorn, *Contracts and Public Policy* (1935) 35 Col. L. Rev. 679.

or expedient to accomplish the purposes for which it is formed and such as are not repugnant to law."[1] This section has given rise to two important questions. Has the statute destroyed the doctrine of ultra vires in Indiana? If not, has the statute changed the doctrine of ultra vires in Indiana, and if so, to what extent?

The term "ultra vires" has been loosely used by the courts and authors.[2] By one definition, an ultra vires act is one legal in its inception, but beyond the *authority* of the parties to perform;[3] by another it is one which the corporation has no *power* under its charter to perform.[4] No definition of an ultra vires act is included in the Indiana statute, but a section imposing penalties for ultra vires acts seems to apply to acts done in excess of the *powers* granted.[5] Apparently the legislature intended to accept the power definition of ultra vires. Since the act gives corporations the capacity of natural persons, it appears that corporate acts are ultra vires only when they are

[1] Ind. Acts 1929, c. 215, § 3, IND STAT. ANN. (Burns, 1933) § 25-202. "This provision is adapted from section 11-I of the Uniform Act [9 UNIFORM LAWS ANN. (Perm. ed. 1932) 56] and, as there stated, is designed to solve the troublesome problem of ultra vires as applied to capacity." IND. GEN. CORP. ACT ANN., p. 6, n. 20. Similar provisions are found in the laws of several other states. PA. STAT. (Purdon, 1936) tit. 15, § 2852-301; OHIO GEN. CODE ANN. (Page, 1939) § 8623-8; IDAHO CODE ANN. (1932) § 29-114; LA. GEN. STAT. (Dart, 1939) § 1092; MINN. STAT. (Mason, 1938 Supp.) § 7492-11. To the same effect, PUB. LAWS OF VT. (1933) §§ 5813, 5817.
The fundamental conflict in authority on the question of ultra vires may be represented by the statement in Central Transp. Co. v. Pullman Palace Car Co., 139 U. S. 24, 59 (1891) that, "The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract can not be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract validity, or be the foundation on any action upon it," as opposed to the statement in Bissell v. Mich. Southern Ry. Co., 22 N. Y. 258, 264 (1860), that, "To say that a corporation has no right to do unauthorized acts, is only to put forth a very plain truism; but to say that such bodies have no power or capacity to err, is to impute to them an excellence which does not belong to any created existences with which we are acquainted."

[2] 7 FLETCHER, CYCLOPEDIA CORPORATIONS (Perm. ed. 1931) § 3399.

[3] This definition is used in Stevens v. Boyes Hot Springs Co., 113 Cal. App. 479, 298 Pac. 508, 509 (1931).

[4] Savannah Ice Co. v. Canal-La. Bank & Trust Co., 12 Ga. App. 818, 825, 79 S.E. 45, 49 (1913). See also Tourtelot v. Whithed, 9 N. D. 467, 479, 84 N. W. 8, 12. (1900).

[5] Section 54 of the statute provides: *"Penalty for ultra vires acts.*— If any corporation heretofore or hereafter organized under the laws of this state shall, under color of any of the *powers granted herein,* commit any act in excess of *such powers,* such act shall be avoidable at the instance of the prosecuting attorney of the county in which the principal office of the corporation is located in a direct proceeding instituted by him against the corporation . . . " (Italics supplied.) Ind. Acts 1929, c. 215, § 54, IND. STAT. ANN. (Burns, 1933) § 25-253.

beyond the legal capacity or power[6] of a natural person. But since the doctrine of ultra vires does not apply to acts illegal or against public policy,[7] no ultra vires act could be committed and the doctrine would be abolished.

If this were the result intended, why was an express penalty provision for ultra vires acts included in the statute?[8] That provision indicates that the legislature did not intend to completely abolish the doctrine in Indiana. The drafters of the Indiana Act have said: ". . . only those acts are ultra vires that are beyond the *authority* of the corporation."[9] Hence they apparently intended to accept the definition that an ultra vires act is one, not beyond the power of the corporation to perform, but one merely beyond its authority. The drafters of the Uniform Business Corporation Act, from which section three of the Indiana Act was patterned,[10] also adopted this definition.[11] Although nothing short of a decision by the court will definitely settle the point,[12] it seems that, the ultra vires doctrine obtains in Indiana and that under the Indiana statute, ultra vires acts are those which are not expressly or impliedly authorized.

Section three of the statute provides: "Each . . . corporation . . . shall have *authority* to perform only such acts as are necessary, convenient, or expedient to accomplish the purposes for which it is formed . . ." In using the word "authority" did the legislature mean: each corporation shall have the *privilege* (permission) to do only necessary acts?[13] Or was "authority" used in its agency concept? If the latter, is the State the source of authority or are the stockholders the source?

If the word "authority" were intended to mean "privilege," an

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[6] Under Hohfeldian nomenclature, the concept "power" is used to denote a situation where one person (or corporation) has a legal control, through the volitional exercise of which, he can change the legal relations existing between himself and another, or between two third persons. "Privilege," on the other hand, denotes "permission." Corbin, *Legal Analysis and Terminology* (1919) 29 Yale L. J. 163. Under this nomenclature, § 3 of the Indiana statute would read: "Each corporation shall have the *power* possessed by natural persons, but shall have the *privilege* to perform only such acts . . . " Harno, *Privileges and Powers of a Corporation* (1925) 35 Yale L. J. 13, 16.

[7] Franklin Nat. Bank v. Whitehead, 149 Ind. 560, 579, 49 N. E. 592, 598 (1898); Chicago, I. & L. Ry. Co. v. Southern Ind. Ry. Co., 38 Ind. App. 234, 241, 70 N.E. 843, 846 (1904).

[8] See note 5 *supra.*

[9] IND. GEN. CORP. ACT. ANN., p. 6, n. 20.

[10] See note 1 *supra.*

[11] 9 UNIFORM LAWS ANN. (Perm. ed. 1932) 61.

[12] "One danger in a statutory scheme, which depends to a large extent for its effect upon the exact meaning of the words 'capacity' and 'authority,' is that the legislature may not be careful to maintain the new phraseology. In the Indiana act, for example, 'capacity' and 'authority' are distinguished in one subsection; 'powers' is used in the next two subsections; and a later section provides a penalty for 'ultra vires' acts Such inconsistency may be fatal to the statute's effecting the desired change in the law." Note 44 Harv. L. Rev. 280, 282 (1930).

[13] This view is advocated in Harno, *supra* note 6, at 13.

ultra vires act would be any act not privileged, and thus the statutory change was one of terminology only. The capacity of a corporation to do an ultra vires act has long been recognized in Indiana.[14] Giving a corporation the capacity of a natural person, would do nothing more than make an already definite proposition of law more definite.

If the agency concept of "authority" is intended and the state is the so-called principal,[15] then also the statute has made no change. Under such interpretation, the ordinary rules of ultra vires would apply to acts done in excess of authority given by the state just as they have previously been applied to acts done in excess of power granted by the state.[16] The drafters of the Uniform Business Corporation Act, from which section three of the Indiana Act was patterned,[17] intended that the agency concept of "authority" apply to the stockholders as principals and the corporate directors and officers as agents.[18] If this interpretation is accepted, the doctrine of ultra vires can be applied only by the state and[19] the principles of agency govern what heretofore has been within the doctrine of ultra vires.

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[14] "Corporations, like natural persons, have power and capacity to do wrong. They may, in their contracts and dealings, break over the restraints imposed upon them by their charters; and when they do so, their exemption from liability can not be claimed on the mere ground that they have no attributes or faculties which render it possible for them thus to act." Wright v. Hughes, 119 Ind. 324, 332, 21 N.E. 907, 910 (1889). Furthermore, a corporation has been held liable for torts done in ultra vires transactions. Dorsey Machine Co. v. McCaffrey, 139 Ind. 545, 551, 38 N.E., 208, 210 (1894). It could hold good title to real estate acquired by ultra vires acts. Baker v. Neff, 73 Ind. 68, 70 (1880); Hayward v. Davidson, 41 Ind. 212, 215 (1872); Pilliod v. Angola Ry. and Power Co., 46 Ind. App. 719, 729, 91 N.E. 829, 833 (1910). Fully executed ultra vires contracts were good foundation for rights acquired thereunder. Iterman v. Baker, 214 Ind. 308, 317, 15 N. E. (2d) 365, 370 (1938); Marion Trust Co. v. Crescent Loan and Inv. Co., 27 Ind. App. 451, 456, 61 N. E. 688, 690 (1901). Recovery might be had on partly executed ultra vires contracts. Wright v. Hughes, 119 Ind. 324, 331, 21 N. E. 907, 910 (1889); Seamless Pressed Steel and Mfg. Co. v. Monroe, 57 Ind. App. 136, 143, 106 N. E. 538, 541 (1914).

[15] This view has been taken as respects the Louisiana Act which is almost identical to the Indiana Act. Bennett, *The Louisiana Business Corporation Act of 1928* (1940) 2 La. L. Rev. 597, 607.

[16] "For if the state is the principal and the corporation the agent in the new agency relationship, lack of authority would seem no less effective than lack of capacity to render unauthorized transactions void." Note 44 Harv. L. Rev. 280, 283 (1930).

[17] See note 1, *supra*.

[18] 9 UNIFORM LAWS ANN. (Perm. ed. 1932) 61. This idea is clearly expressed in two states by statutes which provide that the articles of incorporation shall have the effect as between the corporation and its directors as an authorization of the directors. CIVIL CODE OF CAL. (Deering, 1937) § 345; OHIO GEN. CODE ANN. (Page, 1939) § 8623-8.

[19] This position was judicially advocated in Harris v. Independence Gas Co., 76 Kan. 750, 763, 92 Pac. 1123, 1127 (1907). The penalty provision in the Indiana Act, IND STAT. ANN. (Burns, 1933) § 25-253, provides that the State may bring a quo warranto pro-

While the principles of agency apply equally to corporate and natural principals, the facts upon which ratification are predicated differ. In large corporations a substantial proportion of the shareholders may not be interested in, and may even be apathetic toward, the management of corporate affairs. Hence ratification may be based upon silent acquiescence; or proof of an intention not to ratify might be excluded because of laches. If stockholders are inattentive to corporate affairs, the scope of the authority delegated by them may be held to be extended by reason of such negligence.[20] Though a contract might be beyond the scope of the authority of corporate agents, a third party would be bound either because it was authorized by the body of shareholders or ratified by them—if not by any previous act, then by the act of beginning suit.[21] A third party dealing with a corporate agent, who is acting within the apparent scope of his authority, would be able to recover against the corporation even though the particular contract was beyond the agent's actual authority;[22] but a third party who negligently failed to ascertain that the agent is acting beyond the scope of his authority would not be able to recover against a non-assenting corporate principal. If a corporate body has authorized or ratified such a contract, neither it nor the third party could attack the authority or capacity to make the contract.[23]

Under this interpretation the rights of a non-assenting shareholder appear to be in question. Formerly, in Indiana, a non-assenting shareholder, unless estopped or barred by his laches, could enjoin an act threatened to be done on behalf of the corporation if such act was

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ceeding to avoid an ultra vires act. Unlike the Indiana Act, the statutes of several other states expressly provide who may and who may not introduce the doctrine of ultra vires in court action. See ILL. STAT. ANN. (Jones, 1934) c. 32, § 8; CIVIL CODE OF CAL. (Deering, 1937) § 345; COMPILED LAWS OF MICH. (1934) § 9953; MINN. STAT. (Mason, 1938 Supp.) § 7492-11; OHIO GEN. CODE ANN. (Page, 1939) § 8623-8; PA. STAT. (Purdon, 1936) tit. 15, § 2852-303.

[20] Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 9 Pac. 771 (1886).

[21] Olson v. Warroad Mercantile Co., 136 Minn. 310, 161, N. W. 713 (1917).

[22] Although the doctrine of constructive notice of the contents of a corporate charter has not been used often by Indiana courts, it has met with favor in a few cases and has never been repudiated. Franklin Nat. Bank v. Whitehead, 149 Ind. 560, 578, 49 N. E. 592, 598 (1898); Muncie Nat. Gas Co. v. Muncie, 160 Ind. 97, 100, 66 N. E. 436, 438 (1903); Voris v. Star City Bldg. and Loan Assn., 20 Ind. App. 630, 644, 50 N. E. 779, 783 (1898). The Indiana statute is the only statute in the United States which expressly gives a corporation the capacity of a natural person but fails to destroy the doctrines of constructive notice. See statutes cited *supra* note 1. If Indiana courts revive the doctrine, the possible use of agency principles under the new Act will be destroyed. *See* notes (1925) 10 Corn. L. Q. 498, (1925) 9 Minn. L. Rev. 478, (1913) 26 Harv. L. Rev. 540.

[23] For express statutory provisions to this effect in other states, see citations *supra* note 19.

beyond the scope of corporate authority.[24] The Indiana statute makes no express provision for such an action,[25] but the court probably will continue to follow its former decisions.[26] If such injunctions were not allowed, the only remedy of the non-assenting shareholder would be in a quo-warranto proceeding to forefeit the charter of the corporation, or enjoin the exercise of unauthorized powers.[27]

The preface of the Indiana General Corporation Act Annotated states that: "The new Acts are thought to contain the best features of recent legislation concerning corporations throughout the country, and should *clarify* the law governing corporations in Indiana . . ." This appears to be an overstatement so far as ultra vires is concerned.

P.C.M.

EVIDENCE

PRIVILEGED COMMUNICATIONS

The New York City council appointed a committee to investigate charges of negligence and maladministration at the city-controlled Lincoln Hospital. At the committee hearing, the hospital medical superintendent withheld confidential case record information on the grounds that the New York Civil Practices act prohibited a physician from disclosing any information acquired in attending a patient. Held, the statutory privilege included examination before legislative committees. *New York City Council v. Goldwater*, 31 N. E. (2d) 31. (N. Y. 1940).

At common law, patient-physician communications were not privileged from disclosure in judicial proceedings. However, statutes have changed the rule in the majority of the states. 8 WIGMORE, EVIDENCE (3d ed. 1939) § 2380. In the principal case the court by a liberal interpretation applied the privilege to non-judicial proceedings. It felt the decision was necessary to carry out the policy of the statute. *Buffalo Loan, Trust & Safe-Deposit Co. v. Knights of Templar & Masonic Mutual Aid Ass'n*, 126 N. Y. 450, 454, 27 N. E. 942, 943 (1891). Section 354 of the Civil Practices Act indicates that the privilege applies to *any* examination of a physician as a witness. This was strengthened by dicta in a previous New York case to the effect that witnesses before the commissioner of accounts were entitled to all the privileges and protection extended by law to witnesses in judicial proceedings. *Matter of Herschfield v. Hanley*, 228 N. Y. 346, 127 N. E. 252 (1920).

A dissent advocated restricting the statute to its "primary purpose." *Buffalo Loan, Trust and Safe-Deposit Co. v. Knights Templar and*

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[24] Board of County Comm'rs. v. Lafayette, M. and B. Ry. Co., 50 Ind. 85 (1875); Mercantile Comm. Bank v. So. Eastern Ind. Coal Corp., 93 Ind. App. 313, 169 N. E. 91, 171 N. E. 310 (1929); Wright v. Hughes, 119 Ind. 324, 21 N. E. 907 (1889).

[25] Compare statutes cited *supra* note 19.

[26] The drafters of the Uniform Business Corp. Act expect this position to be taken by the courts. 9 UNIFORM LAWS ANN. (Perm. ed. 1932) 58.

[27] Columbian Athletic Club v. State, 143 Ind. 98, 40 N. E. 914 (1895).