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Ultra Vires Contracts Under Modern Corporate Legislation

By WILLBURT D. HAM

New and pressing problems in corporation law have tended to push aside such traditional topics as corporate powers and the ultra vires doctrine. Yet these subjects still form an integral part of the law of corporations as any modern treatise or encyclopedia on corporation law will quickly reveal. Furthermore, the legal consequences to be attributed to ultra vires contracts remain of the utmost practical importance to the corporate shareholders whose investment is at stake and to third parties whose contracts with the corporation have been challenged. While the frequency with which courts have been called upon to resolve ultra vires litigation has subsided considerably in recent years even in those jurisdictions where no specific legislation on the subject exists, this has not removed the need or the desirability for the inclusion in modern corporation codes of provisions designed to indicate the legal consequences of ultra vires acts.

It was characteristic for early corporate law writers to refer to the confusion and uncertainty which existed in this area of the law. Clark and Marshall, for example, in their treatise on the law of private corporations, written at the turn of this century, remarked that “there is perhaps no part of the law concerning corporations in which we meet with so much difficulty, confusion, and conflict of opinion as in that which relates to the effect of ultra vires transactions.” Machen, writing a few years later and speaking of what he referred to as the “utter confusion” in the authorities, said that “to attempt to unravel the tangle so as to

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1 Clark & Marshall, Private Corporations sec. 204 (1901).
show precisely what rules of law are adopted in each state would be a protracted, if not impossible, task."

These and similar early statements probably were unduly pessimistic but the fact remains the ultra vires doctrine led to an immense quantity of litigation in which the courts developed different theories and assumed conflicting attitudes as to the exact legal nature of ultra vires acts. It is significant that, beginning with Vermont in 1915, nearly one-half of the states have introduced into their corporation codes legislation designed to clarify the treatment to be given ultra vires contracts in private litigation. The statutory provisions involved, however, display differences not only in wording but also in substantive content. It is the purpose of this article to survey the nature of this legislation against the common law background with the thought that a comparative study of existing statutes might prove of value to those charged with the responsibility of drafting new corporation codes or recommending amendments to existing corporation acts.

THE COMMON LAW BACKGROUND

The confusion in the case law pertaining to ultra vires acts referred to by the foregoing writers seems in part at least to have resulted from a lack of precision in the meaning ascribed by judges to the term "ultra vires." It has been said that "possibly there is no term in the whole law used as loosely and with so little regard to its strict meaning as the term 'ultra vires.'" It seems appropriate, therefore, at the outset to focus some attention on the meaning which should properly be given to the expression.

The term "ultra vires" has been defined, according to its strict meaning, as referring to a contract "not within the express or implied powers of the corporation as fixed by its charter, the statutes, or the common law." This definition, typical of modern definitions of the term, is obviously not self-explanatory and needs further amplification to become meaningful. It does not, for example, provide a direct answer to whether irregular exercises of corporate power, or excessive or abusive exercises of such power,

3 2 Machen, Modern Law of Corporations sec. 1021 (1908). See also Thompson, "The Doctrine of Ultra Vires in Relation to Private Corporations," 28 Am. L. Rev. 376 (1894), in which the author said of the doctrine: "After having given a long and attentive study to the subject, the writer affirms that the Anglo-American law with reference to it is in a state of hopeless and inextricable confusion. . . ."

4 7 Fletcher, Private Corporations sec. 3399 (perm. ed. 1931).

5 Ibid.
are to be considered as ultra vires, along with action for which there is a total absence of power.

Granting that there has not always been complete agreement as to the proper answer to such questions, it appears that under the strict meaning of the term "ultra vires" as thus defined, those contracts should be excluded which are unauthorized only in the sense that the particular corporate officer who purports to execute the contract has not the power by virtue of his office or otherwise to act for the corporation in the matter, and those contracts unauthorized only because some prescribed corporate formality has not been observed but which would otherwise clearly constitute the proper exercise of a power within the purposes for which the corporation has been organized.

It is believed, however, that those contracts which involve an excessive exercise of corporate power should be included within the strict meaning of the term, as, for example, where the corporate charter contains a provision limiting the highest amount of indebtedness which the corporation may incur and the corporation borrows in excess of this debt limit. In dealing with such a case, the Kentucky Court of Appeals made the point clear when it said:

Strictly speaking a corporate contract was at first declared to be ultra vires only when it was entirely without the scope and purpose of its charter privileges, and did not pertain to the objects for which the corporation was chartered. . . . But the modern definition of such a contract has been broadened so that the designation now includes, not only those contracts just mentioned, but also others which are beyond the limitations of the powers conferred by the charter, although within the purposes contemplated by the articles of incorporation.

It is also believed that the strict meaning of the term should be understood to include those contracts in which the exercise of power in the particular instance is for an improper purpose

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6 See 7 Fletcher, Private Corporations sec. 3401 (perm. ed. 1931).
7 See 7 id. sec. 3402.
8 Debt limitations, particularly where prescribed by statute, may also raise questions of illegality. In Fletcher's treatise the effect of debt limits is considered in the chapter devoted to illegal contracts rather than in the chapter on ultra vires. See 7 Fletcher, Private Corporations sec. 3619 (perm. ed. 1931).
10 Id. at 521, 186 S.W. at 485.
although the power involved is one which could properly be exercised if for a purpose contemplated by the corporate charter.\textsuperscript{11} Suppose, for example, a corporation formed for the purpose of distributing food products at wholesale and retail were to borrow money to enable it to manufacture men’s ties. While such a corporation would no doubt have power to borrow money to enable it to further its food business,\textsuperscript{12} it would not have power to borrow money for a purpose foreign to that business and its action in borrowing to manufacture men’s ties would constitute an ultra vires act.\textsuperscript{13}

It is important that the ultra vires contract as thus understood be carefully distinguished from the illegal contract. Indeed, failure to distinguish between contracts which go beyond the powers conferred upon the corporation by its charter and contracts which violate a specific statutory prohibition so as to become \textit{malum prohibitum} or which conflict with the general social welfare so as to be \textit{malum in se} may have encouraged the attitude taken by some judges that ultra vires contracts were void and of no legal effect. However, even if an illegal contract may also be said to be ultra vires, it does not follow that all ultra vires contracts are necessarily illegal.\textsuperscript{14}

There is, no doubt, some disadvantage in the use of a term such as ultra vires which is subject to such possible variable meanings. Nevertheless, it is a useful and convenient expression to convey the legal idea which its strict meaning embodies. Perhaps no one has summarized the matter any more realistically than Cook, when he said:

\begin{quote}
This term has been objected to as having no fixed and clear meaning, and to some extent this objection is reasonable. There is no other term, however, that has acquired the significance, general use, and peculiar meaning that are attached to the words \textit{ultra vires}; and consequently the term probably has acquired a permanent place in the vocabulary of corporation law.\textsuperscript{15}
\end{quote}

\textsuperscript{11} See 7 Fletcher, Private Corporations sec. 3550 (perm. ed. 1931).
\textsuperscript{12} See 6 Fletcher, Private Corporations sec. 2610 (repl. vol. 1950).
\textsuperscript{13} See 6 id. sec. 2611.
\textsuperscript{14} This distinction was recognized and discussed by Judge Comstock in the early New York case of Bissell v. The Michigan S. & N. I. R.R. Cos., 22 N.Y. 258, 268-74 (1860).
\textsuperscript{15} 2 Cook, Corporations sec. 667 (6th ed. 1908).
The development which caused the ultra vires contract to take on such an aura of importance was the notion that such contracts were void and of no legal effect. This idea gained a firm foothold in American jurisprudence with the decision handed down by the Supreme Court of the United States in *Central Transportation Co. v. Pullman's Palace Car Co.*, wherein Justice Gray said:

A contract of a corporation, which is ultra vires, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it.\(^{17}\)

This view as to the nature of the ultra vires contract became the settled rule in the federal courts and was adopted by several state courts.\(^{18}\) A number of grounds were offered in support of this doctrine, none of which have proven completely satisfactory, thereby greatly weakening the strength of the "federal rule" and inducing courts to introduce exceptions and qualifications to the doctrine. Fletcher's current treatise on the law of private corporations lists the following five grounds as having been offered in support of the doctrine: (1) want of corporate power to make the contract, (2) illegality, (3) notice of the limitations on corporate power, (4) public policy, and (5) protection of the rights of stockholders.\(^{19}\)

These grounds have been thoroughly analyzed by other writers on the subject of ultra vires,\(^{20}\) and there is, therefore, no desire to undertake a new and independent analysis of them at this time. Nevertheless, it is believed that some discussion of each of the five grounds is desirable as a means of providing a more complete

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\(^{16}\) 139 U.S. 24 (1890).

\(^{17}\) Id. at 59.

\(^{18}\) Stevens lists cases from the following states as having adopted the so-called federal rule: Alabama, Illinois, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, Tennessee, and Vermont. Stevens, *Private Corporations* sec. 70 n. 51 (2nd ed. 1949). Three of these states, Illinois, Maryland, and Vermont, have enacted legislation on the subject.

\(^{19}\) 7 Fletcher, *Private Corporations* sec. 3406 (perm. ed. 1931).

\(^{20}\) See, e.g., the excellent review and analysis by Professor C. E. Carpenter entitled, "Should the Doctrine of Ultra Vires Be Discarded?," 33 Yale L.J. 49 (1923).
understanding of the common law background and a better appreciation of the legislative treatment of the subject.

The first of these grounds, want of corporate power, is a logical deduction from the fiction and concession theories of corporate existence, that is, from the conception of the corporation as an artificial entity deriving its existence from the state. It is reasoned that the corporation has only such powers as are given it by its creator and thus has no capacity to exceed these powers. Whatever merit this argument may have had at a time when corporations were created by special acts of the legislature, it is abundantly clear today that it has little merit under modern general incorporation acts where persons are free to decide for themselves what the nature of their corporation shall be and what powers it shall have. Furthermore, the use of the word "power" is a misnomer. What the law actually is concerned with is not "power" but "authority." As the late Professor Ballantine put it "when it is said that a corporation is a 'person' invested with certain 'corporate powers', this really means that the management is invested by the agreement of those who form it, and those who become members of it, with authority to carry on activities incidental to certain lines of business." If, then, corporate power is a question of "authority" rather than "capacity," it is not true as Justice Gray tried to say in the Central Transportation Co. case that the objection to the contract is "not merely that the corpora-

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21 See 2 Machen, Modern Law of Corporations sec. 1018 (1908); 2 Morawetz, Private Corporations sec. 649 (2d ed. 1886). The limited capacity doctrine is explainable also in part on the deduction the English House of Lords made in Ashbury Ry. Co. v. Riche, L.R. 7 H.L. 653 (1875), as to a legislative intention in the Companies Acts that a company so incorporated should keep within the powers as limited in its memorandum of association. This placed corporations incorporated under the Companies Acts in the same position as those created by special act of incorporation, where it had been established that all acts in excess of the granted powers were void. See 2 Machen, op. cit. supra, sec. 1027. This explanation has considerable significance in relation to modern ultra vires legislation because as Stevens has said: "To the extent that the ultra vires muddle is attributable to a judicially inferred legislative intention, it can be clarified by more explicit legislation." Stevens, Private Corporations sec. 73, at 394 (2d ed. 1949).

22 See Stevens, Private Corporations sec. 47, at 231 (2d ed. 1949); Carpenter, supra note 20, at 59.

23 Ballantine, Corporations sec. 90, at 245 (rev. ed. 1946). For a similar analysis, see Stevens, Private Corporations sec. 47 (2d ed. 1949), wherein the author concludes that, as applied to ordinary business corporations, "the chief significance of corporate authority is that it indicates the contractual limitations placed by the body of shareholders upon the authority of a portion of the shareholders, the board of directors, and the officers, to act on behalf of the entire membership."
tion ought not to have made it, but that it could not make it."

Instead it becomes evident that the corporation, acting through its representatives, could make the contract, but ought not to have done so.

Illegality furnishes poor support for the ultra vires doctrine since, as already indicated, an ultra vires act as such is not an illegal act. A more specific prohibition must exist in the laws of the state for the act to take on the flavor of illegality. Nor is such prohibition to be found in the provisions contained in many corporation statutes both past and present which state that no corporation shall engage in business other than that expressly authorized by its articles of incorporation or the law under which it was organized. It would be possible to conclude from such provisions that any transaction which is not within the purposes as expressed in the articles, or necessarily incidental to the carrying out of those purposes, is void and of no effect because it would become a prohibited act and thereby an illegal act. Instead, however, such statutory provisions have been treated as merely declaratory of the common law rule on which the ultra vires doctrine itself was based. Such an act, then, does not become an illegal act under these statutory provisions, and the common law rules pertaining to the legal consequences of ultra vires acts remain unaffected.

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24 See notes 16 and 17 supra.
25 See 7 Fletcher, Private Corporations sec. 3424 (perm. ed. 1931).
26 See, e.g., Hind v. Cook & Co., 202 Ky. 526, 260 S.W. 349 (1924), in which the Kentucky court held that a specific prohibition in the statutes under which a co-operative or assessment fire insurance company was organized restricting it to the insurance of buildings and property within the limits of the territory prescribed in its certificate of incorporation indicated a public policy which made prohibited contracts more than merely ultra vires.
28 See Joseph Schlitz Brewing Co. v. Missouri Poultry & Game Co., 287 Mo. 400, 229 S.W. 813, 815-16 (1921), in which Judge Blair collected and discussed the authorities in support of this interpretation.
29 See Bailey, "Need for Revision of the Texas Corporation Statutes," 3 Baylor L. Rev. 1, 6-7 (1950). The author called attention in this article to the strict interpretation which Texas courts had been putting upon the statutory provision then in effect in that state that corporations could "enter into any obligation or contract essential to the transaction of its authorized business." He recommended that the wording of this provision be changed so as to "assure to business corporations the authority to enter into any contract, or to perform any act, which may reasonably seem to directors of ordinary judgment and prudence to be necessary or expedient in accomplishing the authorized purpose of the corporation." (Emphasis added.)
The third ground suggested for treating ultra vires contracts as void, namely, notice of the limitations on corporate power, has been subjected to as severe criticism as the first two. The idea behind this attempted explanation of the doctrine is that third parties who contract with a corporation are on constructive notice of the extent of corporate power and so act at their peril. The suggestion has been made that the existence of this concept of notice may have been in part a result of the misconception of ultra vires contracts as illegal. It is then tempting to apply the criminal law maxim that "everyone is presumed to know the law." But, as Professor Stevens has observed, application of the doctrine of constructive notice cannot be supported by analogy to this principle in criminal law since "ultra vires action is not criminal action." Another explanation for the existence of the notice concept is the suggestion offered by Stevens that courts evidently misconceived the real purpose served by the legislative requirement that articles of incorporation be filed in a public office, and should have realized that the purpose to be served by such filing is not to charge the public with knowledge as in the case of ordinary recording acts, but rather is to provide a public record of information available to those who may wish to ascertain the data contained in the papers so filed. Moreover, from the practical standpoint, the use of the constructive notice concept has been found particularly objectionable. In the first place, the point has been made that it is unrealistic and contrary to actual business.

30 See, e.g., American So. Nat'l Bank v. Smith, 170 Ky. 512, 522, 186 S.W. 482, 486 (1916), in which the Kentucky court gave the following reply to the suggestion of defendant (American Southern National Bank) that it was an innocent party with no knowledge of the limitations on the highest amount of indebtedness contained in the articles of incorporation of a bank to which it made a loan of money secured by collateral: "It may be true that the defendant did not have actual notice of the limitations in the charter of the Alexander bank, but under all of the authorities, including the cases upon the subject from this court, it was charged, at the time of the lending of the money with constructive notice of such limitations." For a discussion of the constructive notice doctrine in early Kentucky cases, see Note, "Ultra Vires as a Corporate Defense," 30 Ky. L.J. 224, 225-27 (1942). This doctrine was specifically abolished by the Kentucky General Assembly in 1946 when a new revised general corporation law was adopted. See Ky. Rev. Stat. sec. 271.115 (1956).


33 Stevens, Private Corporations sec. 74, at 338 (2d ed. 1949); Stevens, "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 Yale L.J. 297, 324 (1927).

34 Ibid.
practices to suppose that persons dealing with a corporation can be expected to know the contents of the articles of incorporation. In the second place, it has been observed that even if such persons actually did acquire such knowledge, they would be subject at their peril to deciding whether given action does or does not come within the enumerated purposes or powers of the corporation. Since such decisions often cannot be made with assurance even by lawyers, it is obviously asking much of the business man to shoulder the responsibility for such decisions in his dealings with corporations.

Public policy has sometimes been thought to dictate the necessity of treating the ultra vires contract as void. It can be reasoned that the state, representing the interests of the general public and the welfare of society, has an interest in corporations keeping within the bounds of the business which they have been organized to pursue and that this social policy is furthered by refusing to give legal recognition to the ultra vires contract. This argument has appeal, and to the extent that the particular contract is illegal as well as ultra vires, there may well be a public policy which is best served by treating the contract as void, but it has been observed that, if the only objection to the contract is the lack of authority on the part of the corporation to enter into such a contract, then it may be questioned whether there is any public welfare which is served by striking down the contract, particularly when the corporation could receive the necessary authority by simply amending the articles of incorporation. Instead, the real public policy, it is argued, seems to point in the direction of upholding the sanctity of contract in commercial transactions.

The fifth and final ground mentioned in Fletcher's treatise for treating the ultra vires contract as void, namely, the protection of the rights of the stockholders, probably furnishes the strong-

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35 See Colson, supra note 31, at 297.  
36 See Carpenter, supra note 20, at 62; Colson, supra note 31, at 297-98.  
37 See Stevens, Private Corporations sec. 72 (2d ed. 1949).  
38 Carpenter, supra note 20, at 63-64. See also Stevens, Private Corporations sec. 73, at 326 (2d ed. 1949).  
39 Carpenter, supra note 20, at 64. See also Stevens, Private Corporations sec. 72, at 326 (2d ed. 1949). In speaking of the supposed public policy behind the ultra vires doctrine Senator Estes Kefauver once said: “Public policy is generally vague and untrue. There is also a public policy to prevent men and corporations from breaking their fair contracts.” Kefauver, “The Doctrine of Ultra Vires,” 6 Tenn. L. Rev. 20, 27 (1927).  
40 Another ground sometimes suggested is the protection of intra vires
arguable that can be made in support of the ultra vires doctrine under modern incorporation procedure which, through its flexible provisions, minimizes the outside public interest and emphasizes the specific interests of the inside group of associates. However, while it may be conceded that the inside associates, in their role as stockholders, have a real and active interest in the corporation confining its activities to those specified in the articles, yet as between such persons and those who have dealt with the corporation in good faith with no reason to suspect the transaction is unauthorized, there are strong reasons for placing the risk on the insiders rather than on the innocent third parties. It has been persuasively argued that such a business risk would be placed on an individual principal under the law of agency, as well as on partners under the law of partnership, and that there seems to be no good reason for applying a different principle to stockholders in the case of a corporation.

It is obvious from this brief resumé of the ultra vires doctrine and the reasons offered in support of it, that it was a doctrine which rested on a rather unstable foundation from the very start and which could readily lead to harsh and unjust results if applied literally. It is not surprising, therefore, that the judicial climate tended to become unfavorable as more and more courts were faced with the inherent injustice of the doctrine. Judges began to include in their opinions expressions such as, that "the creditors. But it appears their rights depend upon, and their interests are usually adequately protected by, the law of fraudulent conveyances. See Ballantine, Corporations sec. 104 (rev. ed. 1946); Stevens, Private Corporations sec. 75 (2d ed. 1949). Intra vires creditors ordinarily, therefore, have no standing to challenge a transaction as ultra vires merely on that ground alone. See Pennsylvania R.R. Co. v. Kentucky Public Elevator Co., 217 Ky. 48, 288 S.W. 1024 (1926) (unsecured subsequent creditor not allowed to raise question whether contract for storage of tank cars by elevator company, giving it a lien for storage, was ultra vires especially where cars were not fit for transportation and storage was cheaper than demurrage). In Kentucky, however, where insolvency intervenes, it has been held that general creditors can prevent a mortgagee of corporate property from enforcing its mortgage in priority to their claims for an amount in excess of the debt limit named in the articles of association. Bell & Coggeshall Co. v. Kentucky Glass Works Co., 106 Ky. 7, 50 S.W. 2, 51 S.W. 180 (1899). This and other Kentucky decisions construing the rights of creditors under debt limit provisions are referred to and discussed in 7 Fletcher, Private Corporations sec. 3619 (perm. ed. 1931).

41 This emphasis has not always been so recognized. See, e.g., 2 Morawetz, Private Corporations sec. 692, at 659 (2d ed. 1886), in which it is said: "The legal prohibition against the unauthorized exercise of corporate powers is established for the benefit of the public, on general grounds of expediency, and not for the benefit of corporations, or of persons dealing with them."

42 Carpenter, supra note 20, at 65-66.
defense of ultra vires, whether invoked for or against a corporation, is not favored in the law," and that "it should never be applied where it will defeat the ends of justice, if such a result can be avoided."

In the face of such a judicial attitude, it was inevitable that modifications in the application of the doctrine would be introduced. It became well settled that a fully executed ultra vires contract would be left untouched. This position was accepted even by those courts which had adopted the "federal rule," however illogical this may have been under the view that an ultra vires contract is void. In the interest of security of titles, the courts also uniformly agreed that no attack should be permitted on a corporation's title to property acquired in an ultra vires transaction. Furthermore, as to those contracts which had been executed on one side only, a majority of the state courts took the position that the contract should be enforced at the instance of the party who had performed, at least if the benefits of the performance had been received by the other contracting party.

43 See, e.g., Community Credit Union, Inc. v. Connors, 141 Conn. 301, 105 A. 2d 772, 774 (1954).
44 See, e.g., Palm Beach Estates v. Croker, 106 Fla. 617, 143 So. 792, 802 (1932). These two expressions can be traced to the language of Justice Swayne in San Antonio v. Meahaffy, 96 U.S. 312, 315 (1877). He in turn seems to have relied upon what was said by Judge Allen in the New York case of Whitney Arms Co. v. Barlow, 63 N.Y. 62, 69 (1875). In Behrens v. First Nat'l Bank, 305 Ill. App. 215, 27 N.E. 2d 333, 336 (1940), the Illinois court commented that "The rule of ultra vires is not intended as a license for commercial piracy."

47 See Stevens, Private Corporations sec. 65 (2d ed. 1949). A few states still have statutory or constitutional provisions which authorize the state to forfeit land held by a corporation in violation of authority. See, e.g., Ky. Const. sec. 192:

No corporation shall engage in business other than that expressly authorized by its charter, or the law under which it may have been or hereafter may be organized, nor shall it hold any real estate, except such as may be proper and necessary for carrying on its legitimate business, for a longer period than five years, under penalty of escheat. (Emphasis added.)

See also Ky. Rev. Stat. 271.145 (1956) which repeats this constitutional provision and augments it by outlining the procedure to be followed by the state in bringing actions to escheat such real estate.

48 See, e.g., Joseph Schlitz Brewing Co. v. Missouri Poultry & Game Co., 287 Mo. 400, 229 S.W. 813 (1921). For a collection of authorities from the jurisdictions in which this view prevails, see 7 Fletcher, Private Corporations sec. 3479 (perm. ed. 1931, supp. 1956).

The Kentucky court appears to have aligned itself with the majority rule. One
It was said that the nonperforming party was "estopped" to set up the plea of ultra vires. The courts following the "federal rule," although unwilling to permit recovery on the contract, were willing to concede a recovery in quasi-contract by the performing party based on the value of any benefits received by the other contracting party as the result of performance.

Despite these inroads on the ultra vires doctrine, the almost unanimous position of the courts has been that the purely executory ultra vires contract cannot be enforced. The only breach known to the writer in the consistent line of authority for this proposition appears in *Harris v. Independence Gas Co.*, where the Supreme Court of Kansas, making a clean break with

of the clearest expressions of this view appears in *Liberty Coal Mining Co. v. Frankel Coal Co.*, 206 Ky. 647, 653, 268 S.W. 280, 282 (1924). In *Greene v. Middlesborough Town & Lands Co.*, 121 Ky. 355, 89 S.W. 228 (1905), the court sustained the plea of ultra vires by defendant corporation in a suit against it on a contract of guaranty. While the opinion contains overtones suggestive of the federal rule, it is significant that the evidence established that the defendant corporation never received nor retained anything of value under the contract. See also *Louisa Nat'l Bank v. Sparks*, 206 Ky. 158, 104 S.W. 2d 223 (1937) (semble).

The Kentucky court has also recognized one of the ramifications of the majority state rule, viz., the possibility of assent to, or ratification of, ultra vires acts by all of the shareholders. See *Lincoln Court Realty Co. v. Kentucky Title Sav. Bank & Trust Co.*, 169 Ky. 840, 185 S.W. 156 (1916). This possibility has been denied under the federal rule. See *Central Transportation Co. v. Pullman's Palace Car Co.*, 139 U.S. 24, 59-60 (1890), in which Justice Gray said: "The contract cannot be ratified by either party, because it could not have been authorized by either." In *Shannon's Co-Ex'rs v. Shannon Spring Bed Mfg. Co.*, 313 Ky. 463, 230 S.W. 2d 457 (1950), the Kentucky court held that where a stockholder had participated in a corporate transaction, neither he nor his executors could later challenge the transaction as ultra vires.

49 See *Joseph Schlitz Brewing Co. v. Missouri Poultry & Game Co.*, supra note 48. The estoppel rationale, however, is not entirely satisfactory as an explanation for this result. While it may be argued that in suits by third parties against the corporation, the corporate representatives in dealing with the third party have held out or represented that the corporation has power to contract for the purpose contemplated, the constructive notice doctrine makes it difficult for the third party to meet the reliance requirement. In suits by the corporation against third parties, it is difficult to talk estoppel since it is evident that third parties will have made no representations to the corporation concerning its powers on which it will have relied to its detriment. See *Colson*, supra note 31, at 317. Nevertheless, the majority of the state courts have not hesitated to enforce the "partially executed" ultra vires contract whether the suit be by the corporation or by the third party.


51 See *National Finance Co. v. Cramer*, 156 Minn. 79, 194 N.W. 108 (1923); 7 Fletcher, Private Corporations sec. 3459 (perm. ed. 1931) and cases cited therein.

52 76 Kan. 750, 92 Pac. 1123 (1907).
the ultra vires doctrine, declared that, in the absence of special
circumstances affecting the matter, "neither party to even an
executory contract should be allowed to defeat its enforcement
by the plea of ultra vires."53

The question then becomes, why the need for legislation on
the subject of ultra vires? After all, with the possible exception
of the wholly executory ultra vires contract, the courts themselves
have attempted to correct the undesirable consequences of the
doctrine. It may be asked, should not further corrective treat-
ment therefore be left in the hands of the judiciary?

There are several considerations which suggest a negative
answer to this latter question and which explain the need for
corrective legislation. In the first place the courts have not con-
sistently recognized the modification as to "partially executed"
contracts nor have they been uniform in their application of the
"estoppel" theory, particularly with regard to the receipt of bene-
fits limitation.54 Furthermore, the judiciary has shown no inclina-
tion to accept the position adopted by the Kansas court as to the
purely executory ultra vires contract. This may be because the
decision in that case came too late, for while it is an early case
when looked back upon today, it came at a late stage in the de-
velopment of the common law rules after those rules had tended
to crystallize and even impelled Machen to comment that "at this
late day a court which takes this position without any aTfrmative
legislative sanction would seem to be almost if not quite guilty
of usurping the functions of the legislature."55 Yet the same con-
siderations of justice and business policy which justify allowing a
party the benefit of his bargain, that is, recovery on the contract,

53 92 Pac. at 1127-28.
54 The usual view is that in the absence of evidence of benefits accruing to
the nonperforming party, there can be no estoppel. See, e.g., L. G. Balfour Co.
v. Gossett, 131 Tex. 348, 115 S.W. 2d 594 (1938); Zion's Sav. Bank & Trust Co.
Mackie Mill Co., 193 Wash. 477, 76 P. 2d 311 (1938). This requirement has
been criticized as illogical since the basis for the doctrine of estoppel is detriment
suffered rather than benefit received. Ballantine, Corporations sec. 95, at 251
(rev. ed. 1946). Questions also arise as to the character of the benefit received,
some courts insisting that the benefit derived be direct and immediate and not
merely indirect and remote. See e.g., L. G. Balfour Co. v. Gossett, supra. For a
discussion of New York cases in relation to the question whether the benefit must
be "proportionate" to the liability sought to be imposed, see Note, "Some Aspects
of the New York Doctrine of Ultra Vires Contracts," 29 Colum. L. Rev. 484
(1929).
in the case of the partially executed contract seem likewise to apply to the wholly executory contract.\textsuperscript{56} As said by Judge Mason in the Kansas case:

It might seem reasonable that a system which attempts not only to protect a party to an ultra vires contract from actual loss, but, where equity requires it, to insure to him the actual fruits of his bargain, ought, for the sake of completeness and symmetry, to enable him to insist upon the performance even of a purely executory contract. It certainly seems against conscience that one who has entered into a contract in the expectation of deriving a profit from it, may, upon discovering the probability of a loss, repudiate it, and escape responsibility by raising the question of want of corporate capacity.\textsuperscript{57}

Another unsatisfactory aspect of the judicial treatment of ultra vires contracts, growing out of the distinctions based on the extent of performance under the contract, has been the inability of the courts to agree upon whether a particular contract falls into the executed or executory category. This has proven especially difficult with reference to mortgages and leases.\textsuperscript{58} Yet under the common law rules the rights of the parties are influenced by the designation given the contract.

Finally, it may be noted that despite the willingness of courts to consider \textit{abuse} of power as well as \textit{want} of power as coming within the strict meaning of ultra vires, some courts have tended to be much more receptive to the enforceability of contracts involving a mere abuse of granted power as distinguished from those involving a total absence of such power. A recent case from Massachusetts,\textsuperscript{59} which traditionally has been a federal rule jurisdiction,\textsuperscript{60} illustrates this tendency. The president and treasurer of a theatre corporation, whose charter empowered it, among other things, to own, maintain, and operate "theatres, concert halls, buildings and places of amusement," contracted for the repair and remodeling of a theatre building which he stated his corporation had "taken over" but which the corporation in fact

\textsuperscript{56} See Colson, supra note 81, at 318.
\textsuperscript{57} Harris v. Independence Gas Co., 76 Kan. 750, 92 Pac. 1123, 1124 (1907).
\textsuperscript{58} See 7 Fletcher, Private Corporations secs. 3534-3547 (perm. ed. 1931).
\textsuperscript{59} Wiley & Foss, Inc. v. Saxony Theatres, Inc. 139 N.E.2d 400 (Mass. 1957).
did not own or control. In a suit by the contractor against the corporation to recover for the cost of the work done under the contract, the court denied the defendant corporation the right to avail itself of the ultra vires defense, saying:

Our cases, however, make a distinction between the exercise by a corporation of powers manifestly outside the general authority granted by its charter, and the exercise of powers which, although of the sort which in general the corporation possesses, have been abused in the particular case. In the latter case if the abuse of corporate authority is unknown to the party dealing with the corporation the defense of ultra vires is not available to the corporation. 61

It has been doubted whether such a distinction as this can be justified since "in either case, the contract would be equally within the general common law prohibition against all unauthorized corporate action." 62 Nevertheless, as one writer suggested, it has provided the courts with a convenient "loophole" from the severity of the ultra vires doctrine. 63

The foregoing considerations should suffice to demonstrate the inadequacy of the judicial rules on the subject of ultra vires and the need which has existed for remedial legislation as a means of improving the law in this area. It has been said that "the limitations that stare decisis imposes upon the judicial power to improve the law appear to be such that the formulation of satisfactory rules governing ultra vires transactions awaits action by the legislature," 64 and that "the unsatisfactory jumble of case law

61 139 N.E. 2d at 402-03. Note that the plaintiff was allowed to recover despite the absence of any benefits received by the defendant corporation from the performance of the services. On the question whether receipt of benefits is necessary under the rule allowing recovery in partially executed contracts where there has been abuse of power, see 7 Fletcher, Private Corporations sec. 3562 (perm. ed. 1931).

62 2 Morawetz, Private Corporations sec. 704 (2d ed. 1886). See also 1 Clark & Marshall, Private Corporations sec. 214(c) (1901).

63 Note, "The Mississippi Court and the Doctrine of Ultra Vires," 10 Miss. L.J. 293, 293-99 (1938). See also Illinois Business Corporation Act Annotated 69-71 (2d ed. 1947), in which it is pointed out that the Illinois courts found the distinction between "want" of power and "abuse" of power useful as a means of tempering the harshness of their "void" doctrine.

64 Belsheim, "The Need for Revising the Texas Corporation Statutes," 27 Texas L. Rev. 659, 665 (1949). A good example of this judicial inertia appears in the case of Hamburg Bank v. Ouachita Nat. Bank, 78 F.2d 100, 106 (8th Cir. 1935), where the court, in denying recovery to a third party on an ultra vires contract from which the corporation had received no tangible benefit, said that, despite the harshness of the result, "the settled law cannot be unsettled in order to rescue one who has been improvident from his own inadvertencies."
on this subject can be remedied only by a major operation performed by the legislature." The legislatures have responded by enacting statutes directed at the problem, but as Professor Baker of the Harvard University Law School once remarked, "both the underlying theory and the methods and phrasing of some of these statutes raise challenging questions."

**Legislation**

The first state to attempt legislation on the subject of ultra vires in private litigation was the state of Vermont, which enacted a statute in 1915. The substance of this statute, still a part of the corporation law of that state, is that any act authorized or ratified by the board of directors is to be regarded as the act of the corporation for which the corporation is to be liable, even though such act may be ultra vires, provided a corporation with authority to do such an act might have been formed under the laws of that state at the time the act was done.

This statute, as such, is obviously not a complete treatment of the ultra vires doctrine, for while it abolishes the defense in suits brought against the corporation, it says nothing about the defense in suits brought by the corporation. If this is meant to keep open the defense to a third party when sued by the corporation without regard to the understanding which the third party had with reference to the propriety of the transaction when he entered into the contract, it may seem a bit drastic in its treatment of the corporation and its shareholders. The statute does have the merit, however, of protecting the interests of third party plaintiffs in all types of contracts, whether they are wholly executory, partially executed, or fully executed. Another feature of the statute which makes it an incomplete treatment of the subject is its failure to recognize or account for the well-established right of nonassenting shareholders to bring a suit against the offending officers or direc-

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65 Ballantine, "Problems in Drafting a Modern Corporation Law," 17 A.B.A.J. 579, 580 (1931).
68 See Ballantine, Corporations sec. 108, at 264 (rev. ed. 1946), where, speaking of the Vermont statute, the author says: "This in effect abolishes the doctrine of ultra vires as to lack of authority under the purpose clause as between the corporation and outsiders, although it is not made entirely clear that the corporation will be entitled to enforce rights in respect of such acts."
tors either to enjoin threatened ultra vires action or to recover damages resulting from the carrying on of such transactions.

It was not until twelve years later, in 1927, that any further attempt was made to legislate on the subject. In that year Ohio adopted a new General Corporation Act which contained provisions directed at the ultra vires problem.69 The following year a Uniform Business Corporation Act was approved by the National Conference of Commissioners on Uniform State Laws,70 and this act likewise contained provisions designed to cope with the problem.71

The treatment accorded the doctrine in these two acts is similar but not identical. Both attempted to dispel the historical fallacy that a corporation is a creature of limited capacity by providing that corporations shall have the capacity possessed by natural persons.72 Both acts likewise specifically abolished the doctrine of constructive notice.73

The intent in the Uniform Act was to guide the courts by means of such provisions toward the use of agency principles in

70 See 9 U.L.A. 115 (1957). This act has since been designated a Model Act but will continue to be referred to herein as a Uniform Act to distinguish it from the Model Business Corporation Act prepared by the Committee on Business Corporations of the Section of Corporation, Banking and Business Law of the American Bar Association.
71 See sections 10 and 11 of the act, 9 U.L.A. 140, 142 (1957).
72 See Section 77, Uniform Business Corporation Act, 9 U.L.A. 142 (1957); Ohio Gen. Code Ann. sec. 8623-8 (1934). The provision in the Uniform Act reads: A corporation which has been formed under this Act, or a corporation which existed at the time this Act took effect and of a class which might be formed under this act, shall have the capacity to act possessed by natural persons, but such a corporation shall have authority to perform only such acts as are necessary or proper to accomplish its purposes and which are not repugnant to law.
73 See Section 10, Uniform Business Corporation Act, 9 U.L.A. 140 (1957); Ohio Gen. Code Ann. sec. 8623-9 (1934). The provision in the Uniform Act says: The filing or recording of the articles of incorporation, or amendments thereto, or of any other papers pursuant to the provisions of this Act is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with the corporation shall be charged with constructive notice of the contents of any such articles or papers by reason of such filing or recording.

The Michigan statute on constructive notice excepts from its operation shareholders, officers, and directors of the corporation. See 3 Mich. Comp. Laws sec. 450.9 (1948). The late Justice Wiley B. Rutledge, Jr., of the United States Supreme Court, writing while Dean of the College of Law, State University of Iowa, particularly commended this exception with regard to officers and directors, since he felt they should be expected to know something about their articles and "ordinarily should not be permitted to hide behind a shield of ignorance regarding their contents." Rutledge, "Significant Trends in Modern Incorporation Statutes," 22 Wash. U.L.Q. 303, 319 (1937).
the solution of ultra vires problems.\textsuperscript{74} Under this approach the provisions in the articles of incorporation setting forth the objects or purposes of the corporation would operate as limitations placed by the shareholders on the authority of their chosen representatives to act for them in transacting the business affairs of the corporation, but would not affect the rights of third parties unless they knew or should have known that such limitations existed.\textsuperscript{75} Professor Stevens, the draftsman for the Uniform Act, had become a leading exponent of the agency theory, and had recommended it as the most satisfactory basis for legislative treatment of the ultra vires doctrine.\textsuperscript{76} It was his belief that the two foremost obstacles to using agency principles were the doctrines of limited capacity and constructive notice, and that by eliminating these concepts, the way would be open for courts to solve ultra vires litigation by applying agency law.\textsuperscript{77}

The Ohio Act, however, went a step further and contained a provision directed specifically at the legal effects of ultra vires transactions in private litigation. It read:

No limitation on the exercise of the authority of the corporation shall be asserted in any action between the corporation and any person, except by or on behalf of the corporation against a director or an officer or person having actual knowledge of such limitation.\textsuperscript{78}

Under a provision such as this collateral attack upon the propriety of a corporate contract is permitted in but two instances: (1) suits by the corporation against its directors or officers, and (2) suits between the corporation and third persons with actual knowledge of the scope of the authorized business activity. Furthermore, it will be noted that in the latter instance the defense is available only to the corporation and not to third parties. The states of Kansas,\textsuperscript{79} Michigan,\textsuperscript{80} and Minnesota\textsuperscript{81} have

\textsuperscript{74} See Commissioners' Note to Section 11 of the Uniform Act, 9 U.L.A. 143 (1957).
\textsuperscript{75} See Recent Legis., Ballantine, "Legislative Developments in Corporation Law," 15 Calif. L. Rev. 422, 422-24 (1927).
\textsuperscript{76} See Stevens, "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 Yale L.J. 297 (1927).
\textsuperscript{77} Ibid.
\textsuperscript{78} Ohio Gen. Code Ann. sec. 8623-8 (1934).
\textsuperscript{80} 3 Mich. Comp. Laws sec. 450.11 (1948).
\textsuperscript{81} 2 Minn. Stat. sec. 301.12 (1953).
enacted similar statutes with "knowledge" clauses, all of which limit the use of the defense to the corporation.

The "knowledge" clauses have been the source of comment both as to their intended scope and as to their intrinsic merit, for while it may seem only fair and just to deny a third party who has knowledge the privilege of asserting such a defense when sued by the corporation, it may not be so clear that such a party should be subjected to the defense in his suit against the corporation when he has fully performed on his part. The mere fact of knowledge on the part of the third party does not lead to the necessary inference of moral wrongdoing on his part since his dealings may have been based on the possibility of ratification or assent by the shareholders. Professor Jennings, commenting on the "knowledge" provision in the Minnesota Business Corporation Act suggested that, since under a prior Minnesota decision it had been held that a corporation could not use the defense against a third person who had fully performed even though with knowledge, the act should not be held to require a contrary result. Otherwise, it would have the effect of creating the defense where it had not theretofore existed. On the other hand, at the other extreme, Professor Stevens has observed that the limitation of the "knowledge" clause to actual knowledge interferes with the operation of accepted principles of agency law. He says:

Giving free play to the usual rules of agency, the corporation should be permitted to defend itself against a third person, who, as a prudent man, ought to have acquired knowledge as to the material facts concerning corporate authority recorded both for his benefit and for the protection of the body of shareholders.

The next major step in the legislative treatment of the ultra vires problem came in 1929 as a result of provisions which were

82 See Dodd & Baker, Cases and Materials on Corporations 377 n. 5 (2d ed. 1951), wherein the authors say, in commenting on the "knowledge" provision in the Michigan Corporation Act: "Query whether the meaning is that even if the outsider has performed on his part and even though the benefit of his performance has enured to the corporation, the latter may defeat his action on the contract by a plea of ultra vires and force him to quasi-contract restitutional relief."


added to the corporation statutes of California and which were carried forward, with some modifications, into the new California General Corporation Law of 1931. The essence of these provisions was to abolish completely the defense of ultra vires in litigation between the corporation and third parties. The pertinent portion states that:

No limitation upon the business, purposes, or powers of the corporation or upon the powers of the shareholders, officers, or directors, or the manner of exercise of such powers, contained in or implied by the articles . . . shall be asserted as between the corporation or any shareholder and any third person.

A criticism which had been directed at the proposed provisions of the Uniform Business Corporation Act was that they failed "to go far enough in indicating what practical legal consequences and changes are intended to be produced." A later commentary on the Uniform Act suggested that the generality of the provisions concerning corporate capacity and authority rendered the effect of the act "highly doubtful." That this suggestion is of more than passing interest can be illustrated by reference to a case from the State of Washington, involving a corporation engaged in the manufacture of shingles which had, through its president, guaranteed the payment of hospital expenses to be incurred by a former employee of the corporation. In a suit by an assignee of the hospital against the corporation under the guaranty, the Supreme Court of Washington, in a five to four decision, denied recovery to the plaintiff on the ground that this was an ultra vires contract in which no benefit had been received by the corporation. Although Washington had adopted the Uniform Business Corporation Act, there was no attempt in either the majority or minority opinions to discuss the problem in terms of

86 See Recent Legis., Ballantine, "Changes in the California Corporation Laws (1929)." 17 Calif. L. Rev. 529, 532-33 (1929).
the agency principles contemplated by that act. In fact the
majority opinion showed considerable sympathy for the ultra vires
defense would endanger the investments and savings of
thousands of large and small investors who either own stock
or bonds of a corporation. Such a rule would leave it in the
power of managers or officers of large and small corpora-
tions to destroy the business of such corporations by making
improvident contracts contrary to the business for which
they were incorporated.

In the face of language such as this it behooves draftsmen of
legislation to make their intent plain by clear and vigorous pro-
visions if they are to succeed in bringing about a modification in
the established judicial attitude. To meet this need, an additional
 provision was added to the California statute, which, in its present
form, reads as follows:

Any contract or conveyance made in the name of
a corporation which is authorized or ratified by the direc-
tors, or is done within the scope of the authority, actual or
apparent, given by the directors, except as their authority
is limited by law other than by Part 9 of this division [per-
taining to dissolution], binds the corporation, and the
corporation acquires rights thereunder, whether the contract
is executed or wholly or in part executory.

It is eminently clear, therefore, that in California the door has
been closed to the plea of ultra vires in litigation between the

93 This situation is not peculiar to the State of Washington. It has manifested
itself in other states which have adopted the Uniform Act. See Stone, "Ultra
Vires and Original Sin," 14 Tul. L. Rev. 190, 205 n. 56 (1940), in which the
author said, referring to the distinction between executed and executory ultra vires
contracts: "It has become well settled in Louisiana despite the fact that Section 12
of Louisiana Act 250 of 1928 gives to every corporation the capacity possessed by
natural persons, a provision which was intended to render all contracts of a corpo-
ration for lawful purposes enforceable in the courts."
94 76 P.2d at 314. There were two formal dissenting opinions. In one of
them, Justice Holcomb concluded that the contract of guaranty should be enforced
in view of the detriment suffered by the hospital in reliance upon the guaranty.
He said at 315: "Since the contract in question is neither illegal nor immoral and
was freely made by appellant [the corporation], good faith requires that it be
enforced. To deny its enforcement is to work a legal wrong and an injustice upon
respondent [assignee of claim] and the hospital."
95 Cal. Corp. Code Ann. sec. 803(c) (Deering 1953). Ballantine, com-
menting on the California statute, said that "the California committee has tried to
avoid furnishing diversion to the courts in the form of legislative enigmas, charades,
cross word puzzles or conundrums." Ballantine, "Problems in Drafting a Modern
corporation and third parties. The defense is not even preserved, as in the 1927 Ohio Act, against those persons chargeable with actual knowledge of the unauthorized exercise of power. In answer to the question whether ultra vires should remain a defense in such cases, Professor Ballantine, draftsman of the California Act, answered that the stability of commercial transactions militates against going into the matter of knowledge of power and authority. He said that “persons dealing with corporations should be enabled to rely on the authority of the directors and should not have to consult attorneys on the frequently difficult question of whether a transaction is intra vires or run the risk of proving their ignorance of possible limitations on the authority of the managing board.”

It is significant that Ohio has eliminated from its statute the clause pertaining to knowledge and that the present provision in the new Ohio Corporation Law, effective in 1955, contains a sweeping abrogation of the defense of ultra vires similar to that which appears in the California Act.

Notwithstanding this vigorous treatment of the defense in litigation between the corporation and third parties, the California Act and the Ohio Acts, both past and present, carefully preserve the right of the state to object to ultra vires action by corporations and the right of shareholders to bring suits against directors and officers based on their violation of authority. The California provision states that limitations on authority “may be asserted in a proceeding by a shareholder or the State, to enjoin the doing or continuation of unauthorized business by the corporation or its officers, or both, in cases where third parties have not acquired rights thereby, or to dissolve the corporation, or in a proceeding by the corporation or by the shareholders suing in a

96 Ballantine, “Questions of Policy in Drafting a Modern Corporation Law,” 19 Calif. L. Rev. 465, 475 (1931).

No lack of, or limitation upon, the authority of a corporation shall be asserted in any action except (1) by the state in an action by its against the corporation, (2) by or one behalf of the corporation against a director, an officer, or any shareholder as such, (3) by a shareholder as such or by or on behalf of the holders of shares of any class against the corporation, a director, an officer, or any shareholder as such, or (4) in an action involving an alleged overissue of shares. This division shall apply to any action brought in this state upon any contract made in this state by a foreign corporation.
representative suit, against the officers or directors of the corporation for violation of their authority.\textsuperscript{798}

It will be noted that under this provision of the California Act an injunction may be obtained only in cases "where third parties have not acquired rights thereby."\textsuperscript{799} It seems clear under this provision that the injunctive process is to be available only with regard to future unauthorized transactions and that it is not to be used with regard to existing contracts since this would tend to defeat the underlying purpose of the statute to free third parties from the ultra vires defense.

On the other hand, the section pertaining to ultra vires in the Minnesota Business Corporation Act, although preserving the right of shareholders (or the state) to enjoin the doing or continuance of unauthorized acts, provides that in such cases "the court shall protect or make compensation for rights which may have been acquired by third parties by reason of the doing of any unauthorized act by the corporation."\textsuperscript{800} This provision would appear to cover existing as well as future transactions, and while it seeks to protect the rights of third parties, it seems to weaken considerably the statutory protection afforded innocent third parties who may have inadvertently consummated an ultra vires transaction with a corporation and who then find themselves faced with protracted litigation to maintain their rights. Moreover, Professor Jennings, commenting on this provision, points out that while the Minnesota Act seems to make even the wholly executory contract enforceable, it is somewhat deceptive in this respect since the reservation of the right to enjoin may result in a corporation being compelled to breach a contract it is willing to perform.\textsuperscript{801} He compares in this respect the provisions of the California Act which he concludes restrict the injunctive right to situations where no rights at all have intervened, or, as he says, "to situations where not even an executory contract has yet been consummated."\textsuperscript{802}

\textsuperscript{798} Cal. Corp. Code Ann. sec. 803(a) (Deering 1953).
\textsuperscript{799} This phrase limiting use of the injunction to cases "where third parties have not acquired rights thereby" was one of the changes made in the section when it was revised in the 1931 Act. See Report of Legislative Counsel, as quoted in the notes to Cal. Civ. Code sec. 345 (1931).
\textsuperscript{800} 2 Minn. Stat. sec. 301.12 (1953).
\textsuperscript{801} Jennings, supra note 84, at 429-30.
\textsuperscript{802} Id. at 430.
Shortly after the advent of the California Act of 1931, a new Business Corporation Act appeared in the State of Illinois. This act, which became effective in 1933, modified somewhat the California treatment of the ultra vires defense. The Illinois statute begins with a general statement that no act of the corporation nor any conveyance of property to or by the corporation is to be considered invalid by reason of the fact the corporation lacked capacity or power to so act. There then follow three specific instances in which the lack of capacity or power may be asserted: (1) in a proceeding by a shareholder against the corporation to secure an injunction, (2) in a proceeding by the corporation against officers and directors, and (3) in a proceeding by the state to dissolve the corporation or to enjoin the corporation from the transaction of unauthorized business. It is the first exception which is of immediate interest, since it is buttressed in the statute by a rather elaborate provision outlining the scope and effect of the injunctive right given to the individual shareholder. It is provided in substance that if the injunction is sought in relation to acts under a contract to which the corporation is a party, the court may set aside and enjoin the performance of such contract if all of the parties to the contract are parties to the suit and if the court deems an injunction to be equitable. In granting an injunction the court is directed to allow compensation for loss or damage which either the corporation or other parties may suffer as a result of the setting aside of the contract except that no allowance is to be made for anticipated profits to be derived from the performance of the contract.

104 1 Ill. Rev. Stat. c. 32, sec. 157.8 (1957). The original section as it appeared in the 1933 Act contained a separate provision pertaining to conveyances which to some extent overlapped the provision concerning contract rights. The draftsmen of the Illinois Act explained that this was done because the Illinois law with reference to titles in ultra vires transactions was in such doubt that it seemed desirable to insert a provision with respect to titles separate from the one dealing with contract rights. See Illinois Business Corporation Act Annotated 60 (1934).
105 Ibid. As to the factors which should govern the determination as to when injunctive relief would be "equitable," the draftsmen suggested that it would seem entirely just to set a contract aside where the outsider knew that the corporation was acting without authority and where the shareholders had not authorized or acquiesced in the transaction. See Illinois Business Corporation Act Annotated 61 (1934). A commentator on the act suggested that the extent of performance under the contract, whether executory or executed, might be of importance.
This Illinois provision, on the one hand, by specifically recognizing the propriety of an injunction as to existing as well as future contracts, appears to be more liberal than the provision for injunctions in the California Act, and, on the other hand, appears to be more restrictive than the corresponding provision in the Minnesota Act, where, it will be recalled, there was no direction in granting injunctions to ignore anticipated profits in protecting the rights of third parties. Professor Ballantine, a leading exponent of the view that third parties should be insulated from the plea of ultra vires in commercial transactions, made the following critical observation of the Illinois provision:

This perpetuates much of the old uncertainty and confusion as to the validity of legal transactions which have been some of the worst evils of the doctrine of ultra vires. Such vague, timorous and uncertain provisions are likely to confuse the courts, encourage litigation, unsettle contracts and accomplish no good purpose. Does it not seem an outrage upon the third party to make a contract authorized by the directors binding on him, but not on the corporation if the corporation can persuade some shareholder to bring suit for an injunction and recission? This enables the corporation to speculate at the expense of the third party and deprives a third party contracting with a corporation in good faith of the anticipated profits of his partly executed contract, while reserving a right to such profits to the corporation.107

Despite this vigorous criticism of the Illinois provision, the Committee on Business Corporations of the American Bar Association, in preparing a Model Business Corporation Act, which was presented in 1950 (as revised) for use by states in preparing revisions of their corporation codes,108 adopted the Illinois ap-

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107 Ballantine, “A Critical Survey of the Illinois Business Corporation Act,” 1 U. Chi. L. Rev. 357, 362 (1934). In reply to this criticism, the draftsmen of the Illinois Act said that they were unwilling to follow the California precedent in completely abolishing the doctrine of ultra vires as to outsiders and that the Illinois provision “was designed to permit the courts to work out just solutions in cases in which the California provision would operate unjustly.” Illinois Business Corporation Act Annotated 61 (1934).

108 See American Law Institute, Model Business Corporation Act (Revised
The provision for injunctive relief by shareholders was liberalized even further under this new act. Whereas the Illinois Act states that in setting aside and enjoining the performance of an ultra vires contract the court shall allow compensation for loss or damage sustained by either party resulting from such action, the Model Act merely states that the court may do this. Such change from mandatory to permissive language no doubt serves to intensify the criticism which Professor Ballantine had directed at the Illinois provision, but the prestige of the Model Act gives to its provisions an importance that cannot be overlooked.

Since 1950, seven states, Maryland, North Carolina, North Dakota, Oregon, Texas, Virginia and Wisconsin, as well as the District of Columbia, have adopted new or revised corporation acts which contain a section on ultra vires either the same as or substantially similar to the one contained in the Model Act. Pennsylvania, in its Business Corporation Law of 1933, had already aligned itself with this group of jurisdictions by adoption of a section which closely followed the Illinois provision. Alaska is reported to have adopted a new corporation act,

1950), published by the Committee on Continuing Legal Education of the American Law Institute, collaborating with the American Bar Association.


112 N.D. Sess. Laws 1957, c. 102, sect. 6.
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effective June 27, 1957, based on the provisions of the Model Act.\textsuperscript{119} It is assumed that the section on ultra vires in the Model Act was accepted without change. If so, this makes eleven jurisdictions within the continental United States that now apply the Illinois approach to the subject of ultra vires, and the popularity of the Model Act as a source from which to prepare modernized business corporation statutes may well lead to a further increase in the number of jurisdictions subscribing to this method of handling the problem.\textsuperscript{120} Of the present group, only North Carolina has sought to meet the criticism voiced by Professor Ballantine as to the injunctive provisions of the Illinois Act. In its new Business Corporation Act, effective July 1, 1957, there is added to the provision which preserves the right of a shareholder to bring a suit for an injunction the requirement that “in any such action the plaintiff shall sustain the burden of proof that he has not at any time prior thereto assented to the act or transfer in question and that in bringing the action he is not acting in collusion with officials of the corporation.”\textsuperscript{121}

Although the Illinois approach has proven popular, the California treatment is not without its adherents. In addition to Ohio, which as previously indicated has converted itself to this view,\textsuperscript{122} the states of Nevada\textsuperscript{123} and Oklahoma\textsuperscript{124} have adopted statutory provisions designed to abolish completely the defense of ultra vires.

\textsuperscript{120} Seven jurisdictions have to date adopted new corporation acts based largely on the Model Act. They are: Alaska, District of Columbia, North Dakota, Oregon, Texas, Virginia, and Wisconsin. See Scott, “Developments in Corporate Laws,” 12 Business Lawyer 438, 452 (1957). Although the new North Carolina Business Corporation Act apparently was based also on the Model Act, George C. Seward, Chairman of the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association said at the time of its adoption that “the general spirit of the proposed act differs from the model act to such an extent that the Committee on Corporate Laws prefers to deny any kinship.” Seward, supra note 109, at 4. It is reported that the State Bar Association of Arkansas is working on a new corporation law based on the Model Act, that Colorado has completed preparation of such an act which awaits action by the legislature, and that the State Bar Association of South Dakota has appointed a committee to study the Model Act. See 1 P-H Corp. Serv., Report Bulletin No. 22, May 1, 1957, p. 2-3.
\textsuperscript{122} See note 97 supra.
vires in litigation between the corporation and third parties. One state, Florida, has enacted legislation similar to that of Vermont, but the Florida legislation, like that of Vermont, while recognizing the basic philosophy that ultra vires should be eliminated as a defense, in terms applies the limitation only to the corporation in suits brought against it. Another state, Missouri, has an even more limited provision of this general type, making conveyances of property to or by a corporation immune from collateral attack, but failing to extend this protection to contracts generally.

One of the most comprehensive statutes in this group of states is no doubt the one contained in the Oklahoma Business Corporation Act. In addition to a section emphasizing the responsibility of the corporate representatives to recognize the limitations on corporate authority as defined in the articles of incorporation and authorizing proceedings for "proper relief" where such authority has been exceeded, the act contains an additional section which seeks to spell out carefully the legal position of the corporation and third parties in ultra vires transactions. It is provided that the defense of ultra vires is not to be asserted as to any "contract, conveyance, undertaking, or tortious act," whether executed or executory, if:

1. Such contract, conveyance, undertaking, or tortious act was authorized or ratified by its board of directors or shareholders;
2. With knowledge, actual or constructive, of the facts, the benefits or any part thereof of such transaction have been accepted or retained by the parties so asserting; or
3. The articles of incorporation of such corporation be ambiguous as to the scope of its corporate purposes and under any reasonable interpretation of the articles of incorporation as relied upon by any third party, or his privy, the transaction in question would have been authorized.

One writer, commenting on this Oklahoma provision, has suggested that if no reasonable interpretation of the articles brings a transaction within the purposes of the corporation, then it ap-

127 The section provides: "The defense of ultra vires shall not be available to a corporation sued on a contract or other obligation." (Emphasis added.)
129 Id. sec. 1.29.
pears the corporation is eligible to raise the plea of ultra vires as to a person with knowledge of those purposes.\footnote{\textsuperscript{130}} This suggested interpretation has plausibility, particularly if emphasis is placed on paragraph three of the quoted series of alternatives. The result reached, however, seems to be at variance with the draftsmen's intent as to the scope of this provision which the writer acknowledges was completely to cut off ultra vires as a defense in any contract, transfer or tort action.\footnote{\textsuperscript{131}} If emphasis is placed on the broad language of the first alternative, then it would appear that the statutory inhibition as to asserting the ultra vires defense would prevail if the transaction was authorized or ratified by the board of directors (or shareholders) irrespective of the state of knowledge or lack of knowledge on the part of third parties as to the scope of the corporate purposes set forth in the articles of incorporation.\footnote{\textsuperscript{132}}

This attempt at completeness in the Oklahoma Act indicates another potential pitfall facing the legislative draftsman. The specific enumeration of instances in which the defense is not to be raised may lead to the possible interpretation that in other instances not within the scope of one or more of the enumerations the defense is to be allowed. If, therefore, it was the intent of the draftsmen of the Oklahoma Act to completely abolish the defense, then, as the writer referred to above said of the Oklahoma provision, "it appears to be a strikingly complex method of reaching a result attainable by a direct prohibition."\footnote{\textsuperscript{133}}

The provisions of the Uniform Business Corporation Act relating to corporate capacity and constructive notice constitute the legislative treatment in three states, Idaho,\footnote{\textsuperscript{134}} Louisiana,\footnote{\textsuperscript{135}} and

\begin{footnotes}
\footnotetext{\textsuperscript{131}} Id. at 192.
\footnotetext{\textsuperscript{132}} See Draftsmen's Note, 18 Okla. Stat. Ann. sec. 1.29, at 370-71 (perm. ed. 1953), wherein it is said: "On the matter of whether or not knowledge on the part of the contracting party without the corporation . . . should let in the attack of ultra vires is a disputed question. Ballantine says it should not. Minn., and Mich., have provided otherwise, while Calif. and Ill. did not insert such provision. We adopted what we consider a desirable intermediate ground; that is, that knowledge alone will not let in the plea, but if there is the added element that such party reasonably should know that the agents of the corporation are acting without authority of the board of directors, etc., and the acts would not be approved or ratified later by the directors or shareholders, then and only then, can ultra vires, be pleaded and then only on behalf of the corporation."
\footnotetext{\textsuperscript{133}} Vliet, supra note 130, at 192.
\footnotetext{\textsuperscript{134}} 5 Idaho Code Ann. secs. 30-113, 30-114 (1947).
\end{footnotes}
These states, therefore, may be classed as states which have, legislatively at least, adopted the agency solution to the ultra vires problem. Indiana has a provision on corporate capacity similar to the one contained in the Uniform Act, but has no provision as to constructive notice. The legislative mandate therefore for placing ultra vires in the agency hopper is not as compelling as that of the Uniform Act. However, the significance of the distinction between corporate capacity and corporate authority dictated by this provision makes it seem appropriate to place Indiana in the group of states which have adopted the legislative plan of solving ultra vires problems by application of agency law.

Kentucky is listed in Uniform Laws Annotated as one of the states (along with Idaho, Louisiana, and Washington) which has adopted a corporation law based on the Uniform Act. While it is true that when Kentucky revised its corporation laws in 1946, it made considerable use of the provisions of the Uniform Act, nevertheless there were many omissions from, changes in, and additions to these provisions. Of particular interest and importance in the present connection was the complete omission of the provision in Section 11 concerning corporate capacity. Despite, therefore, the inclusion of Section 10 on constructive notice, this leaves Kentucky without the full statutory plan contemplated under the Uniform Act and in an even more uncertain position as to the effect of ultra vires under its business corporation act than is sometimes asserted as to those states which enacted both sections of the Uniform Act, or which might be asserted as to Indiana with its lone provision on corporate capacity.

136 2 Wash. Rev. Code secs. 23.08.060, 23.08.070 (1951).
138 For a discussion of the implications of the Indiana provision, see Note, "Ultra Vires Acts in Indiana," 16 Ind. L.J. 587 (1941). The Indiana Act contains an additional provision authorizing the prosecuting attorney of the county in which the principal office of the corporation is located to bring a suit against the corporation to avoid ultra vires acts, for which he is to receive a fee of $50. See 6 Ind. Stat. Ann. sec. 25-253 (Burns, 1948 repl.). It has been said of this provision: "No policy is served by authorizing criminal prosecutions for harmless mistakes and deviations from limitations on the business set up by the articles when these are frequently copied by the stenographer from the nearest form book without any serious consideration." Ballantine, Corporations sec. 108, at 269 (rev. ed. 1946).
139 See Table of States Wherein Act Has Been Adopted in 9 U.L.A. 115 (1957).
Whatever justification there may be for according Indiana a position in the list of states that have given legislative treatment to the doctrine of ultra vires, the presence of a provision on constructive notice standing alone hardly seems sufficient to enable one to classify Kentucky as a state which has adopted a legislative plan for the treatment of ultra vires acts.

**CONCLUSION**

It is evident from the foregoing statutory analysis that legislation on the subject of ultra vires has not been uniform. The statutes may be grouped into four general classifications: (1) the "agency" type, exemplified by the Uniform Business Corporation Act, (2) the "knowledge" type, exemplified by the former Ohio statute and the present statutes of Kansas, Michigan, and Minnesota, (3) the "Illinois" type, now embodied in the Model Business Corporation Act, and (4) the "California" type, reflected in the present Ohio statute and in the statutes of Nevada and Oklahoma as well as California.

These differences in treatment reflect the different attitudes which have developed as to the most desirable solution to the policy question which underlies the ultra vires problem. That question is how far the interests of the shareholders demand protection through permitting the defense of lack of corporate power to be raised in private litigation between the corporation and third parties. Professor Ballantine persuasively argued that "the supposed interests of the shareholders have been given exaggerated regard over those of third persons who have dealt with the corporation or its representatives." He added that "the much needed attempts of modern corporation acts to eliminate from the law the evils, quibbles and uncertainties of the pathological, ill-founded decisions on ultra vires, in many states still fall short of attaining the mark aimed at, viz., of making law clear and certain in upholding corporate dealings authorized by the directors." This observation has direct application to the "agency" type and "knowledge" type statutes. If the promotion of stability in commercial transactions is the aim of such legislation, then the observation likewise may be applied to the "Illinois" type statute, since its provision permitting the setting aside of existing con-

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142 Id. sec. 108, at 263.
tracts in suits brought by shareholders necessarily leaves an ultra vires transaction with an outsider vulnerable to possible later attack.

The present writer believes, as Ballantine did, that the interests of the shareholders do not call for this much protection when to allow it tends to unsettle the finality of the business transaction. Rather it seems sufficient if shareholders are given appropriate relief within the corporation against the officers or directors who have been responsible for the unauthorized business. This can be accomplished, as Ballantine suggested, through provisions for injunctive relief against the continuance of such unauthorized business and for the recovery of damages on behalf of the corporation against wrongdoing officers or directors for losses incurred in transactions already completed. This is not to say that third parties should be immune from suit where they have, in collusion with the officers of the corporation, attempted to perpetrate a fraud on the corporation and its stockholders. Here relief is no doubt available independently of the law of ultra vires. But it is to say that in those instances where the only objection to the transaction is that it exceeded the powers of the corporation, third parties are entitled to insulation from harassing litigation instituted by shareholders of the corporation. The interests of the state, that is, the public generally, can be protected through recognition of the right of the state to bring a direct suit against the corporation for forfeiture of the corporate charter or against the corporation and its directors for injunctive relief from the continuance of ultra vires business.

143 Id. sec. 108, at 268.
144 While it is true that collusion between third parties and corporate officers may exist short of actual fraud and that the remedy of the stockholder against wrongdoing officers in a derivative suit is not always feasible, it still may be doubted whether permitting the ultra vires plea to be raised in such cases either directly or through a suit for injunctive relief to set aside the contract is not too high a price to pay for the protection of the stockholders' interests. But see Mangum, "The Doctrine of Ultra Vires in North Carolina," 20 N.C.L. Rev. 405, 418 (1942).
145 It is so provided in Section 6 of the Model Act. See also Cal. Corp. Code Ann. sec. 803(a) (Deering 1953); 1 Ill. Rev. Stat. c. 32, sec. 157.8 (1957). In Kentucky the General Corporation Law speaks of proceedings by the Attorney General "to revoke its corporate powers" where a corporation is guilty of abuse or misuse of corporate power. See Ky. Rev. Stat. 271.590 (1956).
146 Professor Stevens has even expressed doubt "whether the state's interest in transactions which are merely ultra vires . . . is sufficient to justify either an injunction against threatened ultra vires action or an ouster for past ultra vires action." Stevens, Private Corporations sec. 69, at 316 (2d ed. 1949).
It is believed that the foregoing objectives can best be met by a statute prepared with the basic philosophy of the California Act in mind. However, a possible change in the wording of Section 803(b) of the California Act might be considered. It will be recalled that this provision states that “no limitation upon the business, purposes, or powers of the corporation or upon the powers of the shareholders, officers, or directors, or the manner of exercise of such powers, contained in or implied by the articles . . . shall be asserted as between the corporation or any shareholder and any third person.”

This language is broad in scope and appears to cover cases involving irregular exercise of power as well as cases involving want or abuse of power. The provision thus goes beyond ultra vires as understood in its strict and primary sense. It may be doubted whether such an extension is wise since it has the potential effect of making restrictions which appear in the articles as to the mode and manner by which corporate power is to be exercised, and by whom, less binding on third parties with knowledge of such restrictions than would be true if the restrictions appeared in the by-laws. Ballantine apparently justified a result such as this on the theory that by-law provisions are drawn with much more serious regard for limitations on authority and are therefore entitled to more respect. This justification, however, appears somewhat forced when applied to irregular exercises of admitted power, for it would seem that, since articles are frequently more difficult to amend than by-laws, if those responsible for such restrictions took the precaution of placing the restrictions in the articles rather than in the by-laws, they must have intended that such restrictions be given more than the usual attention by persons both within and without the corporation. Therefore, it seems somewhat dubious to extend the drastic treatment accorded ultra vires by this type of legislation beyond the strict and primary meaning of the term.

In those states where the climate of opinion may not be receptive to the complete abrogation of the ultra vires defense achieved by a “California” type statute, the more flexible provisions of the

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147 (Emphasis added.) See note 88 supra.
Model Business Corporation Act are available for adoption. However, if a statute of this latter type is adopted, it is believed that serious consideration should be given to three possible alterations in the provision for injunctive relief by shareholders: (1) use of the word “shall” instead of “may” in the clause pertaining to the allowance of compensation for loss or damage, as has been done in the Illinois Act, (2) inclusion of an additional clause pertaining to collusive suits as has been done in the recent North Carolina Act, and (3) deletion of the clause prohibiting the court from taking anticipated profits into account when awarding compensation where injunctive relief is granted.

While a statutory provision abolishing the doctrine of constructive notice as to charter provisions is probably not necessary under a “California” type statute where the defense of ultra vires is completely abrogated as to third persons, there is some reason to believe such a provision could have importance under the “Illinois” type statute, since otherwise a court would be left free to make constructive notice a basis for granting equitable relief under the injunctive provision. In view of the fact that a provision on constructive notice may have value beyond the ultra vires problem in making clear the purpose served by the requirement that articles of incorporation be filed in a public office, it is believed a section patterned along the lines of the one found in the Uniform Act and made a part of the series of provisions dealing with the preparation and filing of the articles of incorporation would be a desirable, if not indispensable, addition to any modern business corporation act.

150 We are told that the fear of legislative hostility to the section on ultra vires in the Illinois Business Corporation Act was in part responsible for the inclusion of the clause for injunctive relief by shareholders and that much of the hostile criticism which did develop was placated by inclusion of this provision. See Little, supra note 103, at 1003-04 n. 6.


152 See note 121 supra.

153 See the criticism of such a clause in Mangum, supra note 144, at 418-19.


155 This possibility was soon detected in connection with the Illinois Act, which contains no constructive notice provision, but the likelihood of a court considering the mere existence of constructive notice as a sufficient ground for equitable relief was thought to be remote. See Note, Richardson, supra note 106, at 1082-83.

156 See note 73 supra.

157 Several of the existing statutes extend the operation of the ultra vires provisions to foreign corporations. For example, clause (d) of the California statute
It is perhaps too much to assume that absolute uniformity in corporation statutes can or will be achieved. Even the committee which worked so energetically on the Model Business Corporation Act had no such illusion in the preparation of that act. Nevertheless, as Willard P. Scott, a member of this committee, said recently in commenting on corporate law revisions, “inability to obtain perfection is no excuse for failure to make progress.” It is believed, therefore, that those states, including Kentucky, which now have no legislation directed specifically at the ultra vires problem, will wish to give serious consideration to the enactment of appropriate legislation on this subject, so that their states may be added to the growing list of jurisdictions that are contributing, through legislation, to “the decline and fall of the doctrine of ultra vires.” Furthermore, it is assumed that those states which at present have legislative provisions on the subject will wish to avail themselves of the opportunity to reconsider the adequacy of such provisions as a part of the “modernization” process which is constantly necessary to keep corporation codes abreast of current business and legal developments.

reads: “This section applies to contracts and conveyances made by foreign corporations in this State and to all conveyances by foreign corporations of real property situated in this State.” Cal. Corp. Code Ann. sec. 803(d) (Deering 1953).

This provision was introduced into the California statute at the time of the 1931 revision. Professor Ballantine commented: “An interesting feature of the new California provision . . . is extending its doctrine to contracts and conveyances made by foreign corporations in the state, a matter which ordinarily might be regarded as one affecting the internal authority or affairs of the corporation and as such governed by the law of the domicile.” Ballantine, “Problems in Drafting a Modern Corporation Law,” 17 A.B.A.J. 579, 550 (1931).


The propriety of these provisions would appear to be confirmed under Restatement, Conflicts sec. 166, Comment c., which takes the position that the effect of an ultra vires act is to be determined by the law of the state where the act is done. Scott, supra note 120, at 453. Berle, “The Modern Corporation in the Modern State,” 8 Business Lawyer, Nov. 1952, p. 3, 7.
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