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THE ULTRA VIRES QUESTION AS APPLIED TO CORPORATION SUBSCRIBERS AT RECIPROCAL OR INTER-INSURANCE EXCHANGES.

By Hon. William M. Duffy, Louisville (Ky.) Bar.

At the 1916 Session of the General Assembly of Kentucky a law was enacted entitled, "An Act Creating a State Insurance Board," giving to said board the right to regulate the business of fire insurance, defining its duties, etc. I will only quote as much of the title as will enable the reader to recognize it, where to find it and familiarize himself with its provisions. The latter part of the title of the Act provides for the organization and regulation of certain kinds of insurance upon the Reciprocal or Inter-Insurance plan, empowering corporations to participate therein. This law will be found in the Acts of 1916, chapter 19, and the part of the law relating to Reciprocal or Inter-Insurance may be found in Section 25 of said Act at page 126.

It may be well at this point to define and explain Reciprocal or Inter-Insurance. In Kentucky, at least, it is a new scheme of insurance, and with an explanation of the system operated under this scheme, a better understanding of the Ultra Vires question as applied to corporation subscribers at Reciprocal or Inter-Insurance Exchanges may be had.

The best definition of the Reciprocal plan that comes to mind is that it is "an unincorporated Mutual." While this title may be misleading, it is suggested so that the reader may at once recognize that the plan is somewhat similar to the Mutual plan of insurance, with which nearly every one is familiar. The Reciprocal plan insures against any loss except the loss of life. Fire, casualty and compensation are the fields covered. In Kentucky at the present time there are exchanges licensed to do fire, casualty and compensation insurance. For a concrete example let us take up the operation of a Reciprocal exchange doing a fire insurance business. Let us assume that A, B and C are engaged in the dry goods business; they enter into contractual relations with one another to indemnify themselves against a loss by fire. Instead of A, B and C actually visiting the place of business of each other for the purpose of enter-
ing into these contracts, to make inspections and do other things incidental to entering into this scheme of insurance, they usually execute the power of attorney to some one generally known as an attorney in fact, to exchange the indemnifying contracts, make an inspection and have general supervision of the entire matter contained in the contract. One can readily see the necessity of this when one considers cases where a number of dry goods stores located in practically every State in the Union insure each other against a loss by fire under this plan of insurance. Under this contract there is a limited liability. A certain per cent. of the premium is deducted for the expense of maintaining the business, and at the end of each year a dividend is paid back to the subscribers. This dividend consists of that proportion of premium originally paid in, less the amount paid out for losses sustained, operating expenses and a certain amount placed in reserve for future uses.

Under section 25 of the Kentucky Acts of 1916, sub-section 1, "Individuals, partnerships and corporations of this Commonwealth hereby designated subscribers, are hereby authorized to exchange Reciprocal and Inter-Insurance contracts." Section 25 of the Kentucky Acts of 1916, sub-section 8, reads as follows: "Any corporation now or hereafter organized under the laws of this Commonwealth, shall, in addition to the rights, powers and franchises specified in its articles of incorporation, have full power and authority to exchange insurance contracts of the kind and character herein mentioned. The right to exchange such contracts is hereby declared to be incidental to the purposes for which such corporations are organized, and as much granted as the rights and powers expressly conferred."

The question immediately arises: Is this section of the law a violation of section 192 of the present Constitution of Kentucky, which reads as follows: "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."

The law of 1916, as stated herein, gives to the corporation as
well as to the individual the right to make these indemnifying contracts. Does this clause of the Constitution as cited prevent the making of such contracts? Can any corporation, regardless of the purpose for which it was created, enter into an agreement as a subscriber to a Reciprocal Insurance exchange? I have been unable to find any Kentucky authorities bearing directly on this proposition. However, there are a great many decisions construing this section on other similar propositions that have arisen under this prohibitory clause of the Constitution.

The right of business corporations to protect themselves from the loss through the medium of Mutual or Reciprocal insurance has sometimes been before the courts for determination. The objectors in such cases have generally claimed that such corporations had not authority to enter into the contracts of indemnity exchanged between the members or subscribers, because not expressly authorized by their charters to do so, and because such contracts were ultra vires a private corporation.

This term has unfortunately been employed in the law of corporations in many senses and therefrom arises much confusion incident to a proper application of the ultra vires doctrine in the laws of the different states concerning corporations. It is correctly defined as follows:

"Acts which are outside the objects for which the corporation was created as defined by the laws of its organization and therefore beyond the powers conferred upon it by the Legislature. This is the proper use of the term and its employment in any other sense simply occasions confusion. This is its technical meaning."

(American & English Enc. of Law, Vol. 29, p. 43.)

It may be stated as a general rule that the charter of a corporation read in connection with the general laws applicable thereto is the true measure of its power, and a transaction manifestly beyond those powers is ultra vires; yet whatever under the charter and under the laws reasonably construed may fairly be considered as incidental to the purposes for which the corporation was created is not to be taken as prohibited, but is as much granted as that which is expressed.

Thomas v. West Jersey Railway Co., 101 U. S. 71; Pittsburg

If the Act is one which is lawful in itself and not otherwise prohibited, and is done for the purpose of serving corporate ends and is reasonably tributary to the promotion of these ends in a substantial and not in a remote and fanciful sense, it may fairly be considered within charter powers.

Steinway v. Steinway, 17 Misc. (N. Y.) 47.

It has been held that it is not ultra vires of a manufacturing corporation to protect itself from loss by fire by becoming a member of a mutual company.

St. Paul Trust Co. v. Wompach Mfg. Co. (50 Minn. 93, 52 N. W. 274.)

Reciprocal or Inter-Insurance is a form of co-operative insurance which is analogous to mutual insurance, the essential principle of both being the same, namely, protection at actual cost. It has been held that the indemnity from fire loss which business corporations provided for themselves by the interchange of reciprocal or inter-insurance contracts with individuals, partnerships or other corporations is not ultra vires of such corporations.


The Attorneys General of Texas and Kentucky have in the last two years rendered well considered opinions, both holding that it is not ultra vires of business corporations of their respective States to protect themselves through the medium of co-operative forms of insurance.

For the foregoing reasons and under the authorities cited the conclusion is inevitable that the exchange of Reciprocal or Inter-Insurance contracts is not beyond the charter powers of business corporations. It is confidently stated that no case decided by a court of last resort can be cited which holds to the contrary.