



**UNIT 5:
CONSTITUTION OF
COMPANY AND THE
DOCTRINE OF
ULTRA VIRES**

The Constitution

- The constitution of a company refers to the legal document that sets out the fundamental rules, structure, and governance framework for the company's operations. It serves as the company's internal rulebook and establishes the relationship between the company and its shareholders, directors, and other stakeholders. (Section 40 (1) of the Companies Act 2001).
- Initially, the constitution was in the form of a memorandum and articles of association.
- However, in some jurisdictions, the constitution may be a single document called the "Articles of Incorporation" or "Certificate of Incorporation."
- Together, the Memorandum of Association and the Articles of Association form the constitution of the company, outlining the company's objectives, activities, governance structure, and internal rules.
- Any changes to the constitution generally require the approval of the company's shareholders through a special resolution or other specified procedures, as per the laws and regulations of the jurisdiction in which the company is incorporated.

The Constitution

- Under **Section 39 of the Companies Act 2001**, it is stipulated that a company may but does not need to have a constitution.
- The constitution and any amendment made to it must always be certified by a law practitioner.
- Should the constitution contravene the Companies Act 2001, it will be void to the extent of such inconsistency.
- The adoption, alteration or revocation of the constitution is made by special resolution of the shareholders (**Section 44 (1) of the Companies Act 2001**). The board of directors must notify/register the adoption, alteration or revocation of the constitution with the Registrar of Companies within **14 days** of such adoption, alteration or revocation.

The Constitution

- It is important to understand that the shareholders' power to alter a company's constitution must be exercised 'bona fide for the benefit of the company as a whole'.
- This condition was put forward in the UK case of *Allen v Gold Reefs of West Africa Ltd* (1900).

Allen v Gold Reefs of West Africa Ltd
[1900] 1 Ch 656 (CA)

Facts

- The company's articles granted it a lien over partly paid shares. The articles were amended to extend the lien to cover fully paid-up shares.

Principle

- An alteration to the articles will only be valid if it is bona fide for the benefit of the company as a whole.

The Objects Clause and the Doctrine of Ultra Vires

- The **Objects Clause** and the **Doctrine of Ultra Vires** are important concepts related to the constitution and legal capacity of a company.
- The constitution of a company typically includes an object clause that specifies the business or activities the company is authorized to undertake.
- However, according to **Section 27 of the Companies Act 2001**, subject to its constitution, a company has full capacity to engage in any business, activity, or transaction. In other words, a company can undertake any lawful business or activity, even if it is not explicitly stated in its object clause.
- The constitution may impose restrictions on the company's capacity. Despite such restrictions, **Section 28(2)(b) of the Companies Act 2001** states that any act, contract, or transfer of property made by the company in contravention of these restrictions will not be automatically invalid. This provision applies even if the act is not in the best interests of the company.

The Doctrine of Ultra Vires



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- Therefore, if the company acts **beyond the scope of its authorized capacity (ultra vires)**, the resulting contract will still be considered valid.
- This provision aims to protect third parties who may engage with the company in good faith, without being aware of any internal restrictions on the company's capacity.
- In summary, the Companies Act 2001 allows companies in Mauritius to have full capacity to undertake any lawful business or activity, regardless of whether it is specified in the object clause.
- Any act or contract performed by the company, even if it is ultra vires, remains valid, providing protection to third parties who transact with the company in good faith.

The Objects Clause and the Doctrine of Ultra Vires

- **Ostensible Authority:** The doctrine of ostensible authority allows third parties to treat a director/employee as acting within their authority, even if they were acting beyond the scope of their actual authority.
- **Justification for Ostensible Authority:** The company is held bound by the acts of an employee who was unauthorized because the company may have misled the third party into believing the agent's authority was greater than it actually was.
- The case of **Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd (1964)** in the UK provided an explanation of the principle of ostensible authority.

The Indoor Management rule/ the Turquand rule

- The Indoor Management Rule, also known as the Turquand Rule or the Rule in Royal British Bank v. Turquand, is a legal principle that protects third parties who enter into transactions with a company in good faith. The rule simplifies the process for third parties by allowing them to assume that the internal company procedures have been followed, even if they haven't, when dealing with the company.
- In essence, the Indoor Management Rule states that a person dealing with a company from the outside is not required to inquire into the company's internal affairs or check whether the company has complied with all its internal regulations, such as its constitution or internal rules. Instead, the person can rely on the company's external representation of authority and regular business practices.
- The rationale behind this rule is to ensure that third parties are not unfairly prejudiced or held accountable for the company's internal management decisions or irregularities that they have no control over or knowledge of. It provides a degree of protection to external parties who are transacting with a company in good faith and without any notice of potential irregularities.

The Indoor Management rule/ the Turquand rule

- However, it is important to note that **the Indoor Management Rule** has certain limitations. It applies only to transactions with third parties who act in good faith and are not aware of any irregularities. If a third party has knowledge or reasonable suspicion of the company's internal non-compliance, they cannot invoke the rule for protection.
- Overall, the Indoor Management Rule simplifies the process of transacting with a company and protects third parties from bearing the consequences of the company's internal management issues that are beyond their control or knowledge.

The Statutory Contract

- **Section 43 (2) of the Companies Act 2001** establishes that the company's constitution serves as a contract between the company and each shareholder, as well as between the shareholders themselves. Shareholders have the right to enforce the constitution's provisions solely in their capacity as shareholders and cannot seek enforcement in any other position.
- This section allows shareholders to sue the company to enforce their individual shareholder rights, including voting rights, share transfer rights, protection of class rights, pre-emption rights, registration as a shareholder, obtaining a share certificate, and enforcing declared dividends, along with other procedural rights such as receiving notices of meetings.
- Moreover, under this section, a shareholder can also sue another shareholder for breach of a pre-emptive clause that arises during the transfer of shares. However, a shareholder cannot use this section to enforce rights that only have a tangential effect on their shareholding, or to enforce rights as a director that have a tangential effect on their shareholding.

Entrenched Provision

- Shareholders have the option to include entrenched provisions in the company's constitution. These provisions may dictate how a particular clause in the constitution can be amended or deleted, imposing stricter conditions or procedures that go beyond the standard requirement of a special resolution. A notable instance of an entrenched provision can be found in the **UK case of Bushell v Faith (1970)**.
- In the case of Bushell v Faith [1970], the company's articles contained a provision that tripled the voting power of a director when resolutions to remove them were proposed.
- The court held that the Companies Act 1948 did not prohibit weighted voting clauses, so the clause in question was valid and effective.
- This case illustrated that directors could indirectly entrench themselves in their positions by utilizing weighted voting rights as shareholders. These weighted voting rights could be used to defeat any removal resolutions aimed at removing them from office.

The criminal liability of a Company

- According to Section 44 (1) (b) of the Interpretation and General Clauses Act 1974, when a company commits an offense, every person involved in the management of the company at the time of the offense will also be held responsible for the same offense. However, these individuals can mount a possible defense by proving that the offense was committed by the company without their knowledge or consent, and they took all reasonable measures to prevent it.
- In a criminal case, a representative of the company, such as a director, secretary, or any other person duly authorized by the company, can represent the company before the court.

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