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Daniel B. Davis

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This, in effect, applies the English concept of "market overt" to buyers of automobiles from franchised dealers.²⁴

ROBERT J. ROTATORI

CORPORATIONS — ULTRA VIRES AS A DEFENSE IN OHIO

In re B-F Building Corporation,
182 F. Supp. 602 (N.D. Ohio 1960)

The General Electric Corporation and the General Electric Credit Corporation filed claims against the B-F Building Corporation, a bankrupt, on the basis of B-F Building's guarantee of the debts of a related company, the Baird-Foerst Corporation.¹ B-F Building was the owner and lessor of the building in which the Baird-Foerst Corporation, as lessee, carried on its operations. The guarantee was executed by B-F Building in order to help the Baird-Foerst Corporation obtain credit from its suppliers. The trustee in bankruptcy of B-F Building objected to the claims on the ground that the guarantee was an ultra vires transaction, claiming that he was entitled, under the Ohio statute, to raise this fact as defense to the claim.² The referee sustained the objection of the trustee and disallowed the claim. The federal district court affirmed the ruling of the referee.³

An ultra vires transaction has been defined as

some act or transaction on the part of the corporation which, although not unlawful or contrary to public policy if done or executed by an individual is yet beyond the legitimate powers of the corporation as they are defined by statutes under which it is formed, or which are applicable to it, or by its charter or incorporation papers.⁴

An act or transaction is ultra vires only when it is in excess of the authority of the corporation, and thus, when the agent of a corporation has acted in excess of his authority, but not in excess of the authority of the corporation, an ultra vires transaction will not result.

In rejecting the claims of the General Electric Corporation and the General Electric Credit Corporation, the court held that the guarantee made by B-F Building was an ultra vires transaction, in that the corpora-

24. See also UNIFORM COMMERCIAL CODE § 2-403, which protects subsequent purchasers when buying from one whom the public assumes has title to the article which he displays for sale. [Subsequent to the writing of this article, the same Ohio court of appeals which had decided the case under discussion rendered its decision in the companion case of Mutual Fin. Co. v. Kozoil, 111 Ohio App. 501 (1960). In this case, which was based on essentially the same facts as were present in the *Municipal Employees Union* case, the court of appeals decided that Popovic was acting as the agent for Mutual Finance when he sold to the defendant an automobile which was subject to a floor-plan mortgage held by Mutual. The court also decided that the lien of Mutual was acquired subsequent to the sale of the auto to the defendant and therefore the defendant had a prior right to possession of the automobile].

tion had no authority by charter or by law to guarantee the debts of the Baird-Foerst Company. The court recognized that the B-F Building Corporation had statutory authority to guarantee another's debts, if the guarantee was made in carrying out the purposes stated in its articles;⁵ but the court held that the guarantee in question was executed only for the personal benefit of the directors of the B-F Building Corporation and did not serve to carry out the purposes stated in the corporation's articles.

The court further held, with no elaboration, that the trustee, who stands in the place of the bankrupt, could raise the defense of ultra vires as if it were an action against the directors⁶ under Ohio Revised Code section 1701.13(h).⁷

The question as to how ultra vires transactions should be treated has been the subject of much concern and confusion. In 1927, Ohio attempted to solve this problem by statute.⁸ Under the Ohio General Code section 8623.8, corporations were given the capacity of natural persons. This new section also provided that a corporation could not defeat the claim of a third party on the ground that the claim was based upon an agreement which the corporation lacked authority to enter, unless the third party had actual knowledge of the lack of authority of the corporation. This provision, in effect, eliminated the defense of ultra vires.⁹ The theory underlying this provision was that since limitations on the authority of a corporation are primarily the result of an agreement among the parties who organized it, such limitations should not be a means by which the corporation can defeat the claims of innocent third parties who have no actual knowledge of the limitations.¹⁰ It should be noted that these provisions do not contravene the ordinary principles of

1. The guarantee was signed by Baird and Foerst as president and vice-president of B-F Building. Baird and Foerst were the principal stockholders of the Baird-Foerst Corporation, they were the only stockholders of B-F Building, and they were two of the three directors of B-F Building.

2. OHIO REV. CODE § 1701.13(h).

3. *In re* B-F Building Corp., 182 F. Supp. 602 (N.D. Ohio 1960).

4. 2 MACHEN, MODERN LAW OF CORPORATIONS § 1012 (1908).

5. OHIO REV. CODE § 1701.13(f).

6. OHIO REV. CODE § 1701.13(h)(3).

7. This section provides that: "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 it against the corporation, (2) by or on behalf of a 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 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."

8. Ohio Gen. Code § 8623.8.

9. *State ex rel. Fulton v. Hudson Lumber Co.*, 20 Ohio L. Abs. 621 (Ct. App. 1935).

10. See Ballantine, *Proposed Revision of the Ultra Vires Doctrines*, 12 CORNELL L.Q. 453 (1927).

agency.¹¹ Thus, a third person who, in dealing with the agent of a corporation, knew, or as a reasonable man should have known that the agent was acting in excess of his authority, may not hold the principal responsible.¹²

Under the present statutory provision,¹³ ultra vires transactions are treated in substantially the same manner as they were treated under the Ohio General Code section 8623.8. Should, then, a trustee in bankruptcy be entitled to raise the defense of ultra vires against a third party whose claim is in fact based upon an ultra vires transaction? The court, in *In re B-F Building Corporation*, answered yes. The court attempted to justify its position by holding that the trustee could raise this defense as if this were an action against the directors under Ohio Revised Code section 1701.13(h)(3).¹⁴ This, however, was not a stockholders' action against the directors as described in that section, and to allow the trustee to defeat the claim on this basis completely ignores the reasoning behind the statutory provision. One of the primary reasons for adopting a statutory provision of this nature was to protect innocent parties, who have dealt with the corporation in good faith, from just such harsh effects.¹⁵ A corporation acts through its agents, and if the agents have the apparent authority to do particular acts, the corporation should not be entitled to escape liability merely because the act was ultra vires.¹⁶ The holding in *In re B-F Building Corporation* allows a corporation to defeat the claim of a third party which is based upon an ultra vires contract, even if the corporation has clothed its agents with the apparent authority to enter into the contract. This result cannot be justified under Ohio Revised Code section 1701.13(h)(3).

Under Ohio law, the proper approach to take in examining a claim of the nature involved in the present case, would be to disregard the corporate nature of the business organization. By taking this approach, the doctrine of ultra vires would not be considered and principal and agent would be one and the same. The validity of a claim of a third party against a corporation should be determined solely by the principles of agency. A third party who has dealt with an agent of a corporation should, accordingly, be treated in the same manner as a third party who has dealt with an agent of an individual, the result apparently contemplated under Ohio Revised Code section 1701.13(h).

DANIEL B. DAVIS

11. For a discussion of the effect which should be given to ultra vires transactions, see Stevens, *Ultra Vires Transactions Under the New Ohio General Corporation Act*, 4 U. CINC. L. REV. 419 (1930).

12. *Id.* at 439.

13. OHIO REV. CODE § 1701.13(h).

14. See note 7 *supra*.

15. See *Report of Special Committee on Revision of Ohio Corporation Law* 58 (1926).

16. DAVIES, OHIO CORPORATION LAW 219 (1942).