

First Supplement to Memorandum 76-8

Subject: Study 77.20 - Nonprofit Corporations (Organization--Powers; Ultra Vires)

The modern view of corporate authority generally is that a corporation has substantially all the powers to achieve its purposes that a natural person has. This view is reflected in both Section 207 of the new General Corporation Law ("a corporation shall have all of the powers of a natural person in carrying out its business activities") and in Section 9501(h) of the General Nonprofit Corporation Law ("every nonprofit corporation may . . . do all other acts necessary or expedient for the administration of the affairs and attainment of the purposes of the corporation").

Because of the broad scope of corporate powers, the doctrine of ultra vires has become of minimal importance in contemporary corporation law. It has some importance, however, particularly in the case of nonprofit corporations where the corporation chooses in its articles to limit its powers or purposes. In such a case, where a corporation takes action that is beyond its corporate powers or purposes, ultra vires may be used as a defense only in a very limited number of situations. The limitations are imposed by Section 803, which is continued in the new General Corporation Law as Section 208 and which is fully applicable to nonprofit corporations. See, e.g., Osteopathic Physicians & Surgeons v. California Medical Ass'n, 224 Cal. App.2d 378, 36 Cal. Rptr. 641 (1964); California Canning Peach Growers v. Harkey, 11 Cal.2d 188, 78 P.2d 1137 (1938). The following discussion of the California statute is derived from 1 Ballantine & Sterling, California Corporation Laws § 65 (4th ed. 1975).

Under the California statute, ultra vires is abolished as between the corporation and third parties. However, members or the state may still

enjoin the corporation from engaging in unauthorized activities where third parties have not acquired rights thereby. Directors may also be held responsible for losses from negligently engaging in unauthorized acts. This is adequate protection for the members of the corporation without invalidating legal transactions with outsiders. Third parties in dealing with the corporation are thereby made secure, and the corporation cannot in its relation with its promisees, creditors, purchasers, grantees, and encumbrancers go behind the authorization of the directors and show that the particular act was outside the authority of the management because it was contrary to the purposes or its articles. It is as unreasonable to charge third persons with notice of the contents of the articles as it would be to charge them with notice of the by-laws. The doctrine of constructive notice to all the world of charter limitations upon the authority of directors has been impliedly abolished.

Even where a person deals with a corporation with actual knowledge that the managers are acting outside the corporate authority, the better policy seems to be that ultra vires should not be a defense. The idea is to make legal transactions as safe and certain as possible by doing away entirely with the danger of having to litigate this question of knowledge of purpose and authority. The corporate powers and purposes clauses in the articles are customarily very broad and made as inclusive as possible. Persons dealing with corporations should be enabled to rely on the determination of authority made by the directors.

If a contract be contrary to statutory prohibitions or limitations on the corporation or its representatives, or contrary to public policy, it is void. An express exception is, however, made as to statutory limitations on the authority of directors in connection with dissolution and winding up. If a third party knowingly participates in the perpetration of any fraud upon the

corporation or any abuse of authority by its officers, that, of course, would be a defense or ground of invalidity.

Section 803 also extends its application to contracts and conveyances made by foreign corporations in this state and to conveyances of real property situated in this state.

The staff believes that these provisions are sound and should be continued without change in the new General Nonprofit Corporation Law. See the attached draft. In addition, the Commission has previously determined that the court should have equitable authority to enjoin the performance of an ultra vires contract of a charitable corporation. This provision is also attached.

Respectfully submitted,

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§ 5231. Defense of ultra vires

5231. (a) No limitation upon the activities, purposes, or powers of the nonprofit corporation or upon the powers of the members, officers, or directors, or the manner of exercise of such powers, contained in or implied by the articles or by Chapters 18, 19, and 20 shall be asserted as between the nonprofit corporation or any member and any third person, except in a proceeding (1) by a member or the state to enjoin the doing or continuation of unauthorized activities by the nonprofit corporation or its officers, or both, in cases where third parties have not acquired rights thereby, (2) to dissolve the nonprofit corporation, or (3) by the nonprofit corporation or by a member suing in a representative suit against the officers or directors of the nonprofit corporation for violation of their authority.

(b) Any contract or conveyance made in the name of a nonprofit corporation which is authorized or ratified by the board, or is done within the scope of authority, actual or apparent, conferred by the board or within the agency power of the officer executing it, except as the board's authority is limited by law other than this division, binds the nonprofit corporation, and the nonprofit corporation acquires rights thereunder whether the contract is executed or wholly or in part executory.

(c) This section applies to contracts and conveyances made by foreign nonprofit corporations in this state and to all conveyances by foreign nonprofit corporations of real property situated in this state.

Comment. Section 5231 continues provisions applicable to nonprofit corporations by former Section 803 through former Section 9002. See, e.g., Osteopathic Physicians & Surgeons v. California Medical

Ass'n, 224 Cal. App.2d 378, 36 Cal. Rptr. 641 (1964). For a comparable provision, see Section 208 (General Corporation Law). For an exception to Section 5231, see Section 5232 (enjoining ultra vires act of charitable corporation).

Note. The staff has not yet drafted provisions relating to dissolution or to foreign nonprofit corporations. The staff has not yet researched whether the board's authority is limited by law outside the General Non-profit Corporation Law.

§ 5232. Enjoining ultra vires act of charitable corporation

5232. (a) Notwithstanding Section 5231, in the case of a nonprofit corporation that holds its assets on any trust or that is organized for a charitable purpose, a limitation described in subdivision (a) of Section 5231 may be asserted by a member or director of the nonprofit corporation in an action to enjoin the doing or continuation of unauthorized activities by the nonprofit corporation or its officers, or both, regardless whether third parties have acquired rights thereby.

(b) In an action under this section, the court may enjoin the performance of a contract if all the parties to the contract are parties to the action and if it is equitable to do so. The court shall award damages to third parties for any loss or damage sustained as a result of the injunction; however, the court may, if it is equitable to do so, exclude anticipated profits from the award.

Comment. Section 5232 is new; for a comparable provision, see ALI-ABA Model Nonprofit Corporation Act § 6(a). See also Holt v. College of Osteopathic Physicians & Surgeons, 61 Cal.2d 750, 40 Cal. Rptr. 244, 394 P.2d 932 (1964) (minority trustees of charitable corporation may seek to enjoin unauthorized corporate activity). Section 5232 establishes an exception to the limitations on use of the ultra vires doctrine found in Section 5231.