RIGHTS UNDER UNAUTHORIZED CORPORATE CONTRACTS.

A COMMENT ON PULLMAN'S PALACE CAR CO. V. CENTRAL
TRANSPORTATION CO., 171 U. S. 138.

The Supreme Court of the United States seems to have finished the task which it set for itself some years ago of working out a complete theory of the rights of parties to unauthorized corporate contracts. The Court in *Thomas v. Railroad* (101 U. S. 71; 1879) gave its adherence to the doctrine of special capacities and refused to accept the common law doctrine of general capacities which was strongly urged by counsel. In *Pennsylvania Co. v. St. Louis, etc., R. R.* (118 U. S. 290; 1885) the judges decided (against Mr. Justice Bradley's dissent) that where a corporate contract is unauthorized and the action is necessarily founded upon it, no recovery can be had against a defendant in default, even when the defendant has had all that was bargained for. In *Central Transportation Co. v. Pullman's Palace Car Co.* (139 U. S. 24; 1890) the decision in the previous case was emphasized by the announcement of a similar conclusion in an action based upon a contract, although the facts (differing in this respect from the earlier cases) were such as would have supported an action in quasi-contract. In all these cases the defendant was in default under an unauthorized lease and the suits were suits to recover the compensation stipulated for in the contract. The decisions all proceeded upon the theory that when a corporation affects to make a contract which is beyond the scope of its chartered activity, its attempt is utterly futile and the resulting agreement is one which will, under no circumstances, be enforced either at law or in equity. It seemed at the time to be clear to a reader of these decisions that a corporation which had become a party to an unauthorized or prohibited contract was under a duty "to rescind and abandon the contract at the earliest moment, and that the performance of that duty, though delayed for several years, was a rightful act when done." (See 34 Am. Law Register and Rev. 308). When, however, there arose a case in which the lessor, under an unauthorized lease,

was recalled to a sense of duty by his discovery that he had made a bad bargain, the Court refused to lend him the equitable aid necessary to enable him to rescind the contract and regain possession of the demised property. In other words, after deciding that a defendant lessee was not bound to pay rent if he found it inexpedient to continue the lease, the Court denied to the lessor the reciprocal right to cancel the lease at his option, and take the subject matter out of the hands of the lessee.* This eccentric decision was rendered all the more remarkable by the apparent satisfaction with which Mr. Justice Gray cited in support of the Court's conclusion a number of authorities which were applicable only to a case in which the defendant and not the plaintiff was in default under the unauthorized contract.† (See 34 Am. Law Register and Rev. 309 et seq.) Throughout the whole series of cases, however, one result was consistently arrived at by the Court—the denial of relief to a plaintiff who sued upon the contract for money at law or for a restitution of the property in equity. It remained for the Court to give an air of symmetry to its theory by rendering a decision in a case in which the lessor should be seeking to recover, in an equitable proceeding, both the demised property and also compensation for its use. Such a case was certain to arise sooner or later, and it so happened that the precise question was presented to the Court in the final stage of the litigation which had already produced the decision in *Central Transportation Company v. Pullman's Palace Car Co.* in 139 U. S. 24. The decision in question is *Pullman's Palace Car Co. v. Central Transportation Co.*, 171 U. S. 133; (1898). In order to arrive at a clear understanding of the significance of this decision it is necessary to begin by summarizing briefly the successive stages of the litigation. It is aside from the purpose of this paper to discuss that portion of the decision which deals with the lessor's lack of authority to make the lease. It will be assumed that the lessor was a quasi-public corporation and that the necessary legislative permission was wanting. (See 34 Am. Law Register and Rev. 301 et seq.) A corporation was organized under the general manufacturing corporation law of Pennsylvania, and the purpose of its incorporation was stated to be 'the transportation of passengers in railroad cars constructed and to be owned by the said company' under certain

* *St. Louis, etc., R. R. Co. v. Terre Haute and Indianapolis R. R. Co.*, 145 U. S. 393.

† See, for example, *Spring Co. v. Knowlton*, 103 U. S. 49.

patents. The Pullman's Palace Car Company was desirous of obtaining a lease of all the cars of the Pennsylvania corporation, and, in order that all doubt as to the right of the latter to make such a contract might be removed, application was made to the legislature for a special act, which extended the period of corporate existence for a term of years, authorized an increase of its capital stock and expressly empowered it "to enter into contracts with corporations of this or any other state for the leasing or hiring and transfer to them or any of them," of its "railway cars and other personal property." Eight days after the passage of this act the lease was executed and for some sixteen or seventeen years the company lessee paid the stipulated rental when and as the same became due. The company lessee at the end of a nine months' period for which no rental had been paid refused to pay upon the lessor's demand, on the ground that the contract of the lease was invalid. In this position the lessee was sustained, first, by the United States Circuit Court for the Third Circuit, and afterwards by the Supreme Court of the United States. Mr. Justice Gray, in delivering the opinion of the Supreme Court, adopted the view that the corporation lessor, originally a strictly private corporation organized like large numbers of others in Pennsylvania under the general manufacturing corporation law, became a quasi-public corporation with public duties to perform in virtue of the special act, which increased the duration of its corporate life and authorized an increase of its capital stock. The corporation, being in this view a corporation with public duties to perform, could make no lease of its property without legislative consent; and he voiced the opinion of the court to the effect that the legislative authority to make a lease could not, in this case, be construed to authorize a lease of all the property of the corporation, since such a contract would involve the abdication by the corporation of the powers which it possessed and the cessation by it of the performance of the duties imposed upon it by law. Having decided that the contract of lease was 'unlawful and void, because it was beyond the powers conferred upon the plaintiff by the Legislature,' the court decided that no performance on either side could give the unlawful contract any validity or be the foundation of any right of action upon it. 'Whether this plaintiff could maintain any action against this defendant in the nature of a *quantum meruit*, or otherwise, independently of the contract need not be considered, because it is not presented by this record, and has not been argued. This action,

according to the declaration and evidence, was brought and prosecuted for the single purpose of recovering sums, which the defendant had agreed to pay by the unlawful contract, and which, for the reasons and upon the authorities above cited, the defendant is not liable for.' Mr. Justice Gray thus states the reason for the rule, which is applied to this case: "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. The contract cannot be ratified by either party, because it could not have been authorized by either."

Before the decision just summarized had been rendered the Pullman Company filed a bill in equity in the Circuit Court seeking to restrain the prosecution of pending suits for rent and also to enjoin the institution of new suits. The Pullman Company stated its willingness to pay to the Transportation Company such sums by way of compensation for the use of the property as the Court should think fit. The bill averred the invalidity of the lease and prayed that the Court declare the lease void and not enforceable beyond the obligation to make return of the property or just compensation for such of it as could not be returned. There was also a prayer for an account. The Transportation Company by answer denied the averments of the bill in regard to the invalidity of the lease. The Court declined to enjoin pending suits for rent, but granted the prayer as far as new suits were concerned. When the Supreme Court rendered its decision declaring the lease invalid and refusing a recovery to the lessor, the Pullman Company found itself embarrassed by the pendency of its bill in equity in which it had offered to make just compensation for the property. The Pullman Company accordingly moved to dismiss its own bill, but the Transportation Company opposed the motion and took advantage of its opportunity by asking leave to file a cross-bill in order to avail itself of the lessees' tenders of relief. The Circuit Court refused the Pullman Company's motion and allowed the Transportation Company to file the cross-bill. This bill conceded (as under the decision in 139 U. S. it was bound to concede) that the lease was invalid; and it was so framed as to take advantage of the Pullman Company's offer of compensation. The cross-bill also prayed that the Pullman Company be

declared trustee for the Transportation Company of certain contracts and patents (the benefit of which had passed to the Pullman Company under the lease) together with the past and future proceeds of operating under them. The cross-bill also asked for discovery and an accounting. The Pullman Company demurred: (1) on the ground that the cross-bill was filed contrary to the practice of the Court and that the Court had no jurisdiction thereof; (2) to that part of the cross-bill which related to the trusteeship of patents and contracts; and (3) to that part of the cross-bill relating to the account of past and future proceeds. The demurrers were overruled with leave to present the question on final hearing. The Pullman Company then answered the cross-bill, reasserting the invalidity of the unauthorized lease, and "that being null and void between the parties hereto because of such character of the agreement, it cannot be made the lawful foundation of any action or application for any relief whatever between the parties thereto." And this respondent submits that the rule which precludes the granting of relief by any Court of either equity or law upon a contract void for contravention of public policy, forbade this Circuit Court to allow such affirmative relief upon this cross-bill which asserts no claim of right not founded directly upon the express understandings of this contract of lease, held void by this Court itself and by the Supreme Court for the reasons aforesaid." The answer further denied the existence of any duty to return the property or account for it. After hearing proofs, the Circuit Court held that it was a case for an accounting for the value of the property delivered to the lessee *plus* the earnings since the date of such delivery *minus* the rent already paid for the same. The Court referred the case to a master who recommended a decree in favor of the Transportation Company for \$4,235,044 and costs. The Pullman Company appealed to the Supreme Court and also to the Circuit Court of Appeals. The appeal direct to the Supreme Court was taken upon the theory that the Pullman Company had been deprived of its right of trial by jury. The motion to dismiss the appeal to the Circuit Court of Appeals was refused. A motion was then made in the Supreme Court to dismiss the appeal and an application was made for a certiorari to the Circuit Court of Appeals of the Third District; which application, "on account of the peculiar circumstances"—as the case would come before the Supreme Court in one way or the other—was granted and the record was returned by virtue of the writ.

The Court, speaking by Mr. Justice Peckham, approved the refusal of the Court below to allow the original bill to be withdrawn and also the granting of the Transportation Company's motion for leave to file the cross-bill. The Court then proceeded to pass upon the lease and declared it to be void as being beyond the corporate power of the lessor and as involving an abandonment of duty. The Court also intimated that there was strong ground for condemning the lease as being in unreasonable restraint of trade. "In making the lease," said the Court, "the lessor was certainly as much in fault as the lessee." The arguments based upon ratification by performance and estoppel of the defendant to deny the validity of the lease were reviewed and discarded. *Bath Gas Light Company v. Claffy* (151 N. Y. 24) had been pressed upon the consideration of the Court as illustrating the prevailing tendency of American Courts to enforce so-called *ultra vires* contracts between the parties. "It is true," said the Court, "that Courts in different states have allowed a recovery in such cases. . . . but in the case of this lease now before the Court a recovery of the rent due thereunder was denied the lessor, although the lessee had enjoyed the possession of the property in accordance with the terms of the lease." The Court thus announced its determination to adhere to its views as already promulgated and proceeded to assimilate the case of an unauthorized lease to the case of an immoral or illegal contract, remarking, "*Ex dolo malo non oritur actio.*" "In no way and through no channels, directly or indirectly, will the Courts allow an action to be maintained for the recovery of property delivered under an illegal contract where, in order to maintain such recovery, it is necessary to have recourse to that contract. The right of recovery must rest upon a disaffirmance of the contract, and it is permitted only because of the desire of the Courts to do justice as far as possible to the party who has made payment or delivered property under a void agreement and which, in justice, he ought to receive."

Coming next to the question of what, in justice, the Transportation Company had a right to receive, the Court assented to the view of the Court below that the lessor was entitled to recover back the property or its value. The Court, however, refused to recognize the market price of the lessor's stock at the date of the lease as being an indication of the value of the property, and also refused to take into consideration the contracts and patent rights, which, before the date of the return of the property, had gradually passed out of existence by limi-

tation of time. The amount fixed by the decree below was accordingly reduced to \$727,846.50 with interest from January 1, 1885. It thus appears that the Court, while treating an unauthorized railroad lease as immoral and illegal, and while unwilling to give equitable aid to a plaintiff who seeks to disaffirm it, is nevertheless ready to give relief to a plaintiff whose primary wish is not to disaffirm, but to enforce.

The progress of this *cause celebre* has been described in considerable detail, not merely because its progress is instructive, but because of certain practical questions which are suggested by it. It must not be forgotten that corporation law is a department of commercial law, and that it is of paramount importance to the community that it should lend itself to the legitimate needs of business men. Its rules should be readily comprehended and readily applied. The corporation is almost as common a figure in the world of industry and industrial enterprise as is the individual merchant or trader. We cannot long tolerate a legal system which requires of us one or the other of two kinds of commercial conduct according to whether we deal with an individual or a corporation. If difficulties and disputes arise, the means of settling them promptly by appeal to the courts must be at hand. How far does the Supreme Court's theory of rights under unauthorized corporate contracts conform to the standard of commercial expediency? The case in hand furnishes us with material from which to form a conclusion. When the lease was originally proposed in 1870, competent counsel was retained to draw an act of legislature authorizing the making of it. The act was carefully drawn and duly passed and the lease was executed eight days afterward. The parties conformed to the terms of the agreement until 1885, when the lessee repudiated it. It is a fact that none of the able counsel who at the time represented the parties believed for a moment that the lease was void for lack of authority. It was simply a case in which the lessee thought that a strategic advantage could be gained by taking chances with the law. That the defense of "ultra vires" was an afterthought, appears from the circumstance that it was not interposed among the various defenses to the first suit for rent. See 139 U. S. 62. In the next suit the defense was set up and the Court below sustained it. It took five years from the date of default to obtain a decision of the Supreme Court which, to the surprise of all concerned, declared the lease invalid on the ground that such a lease was not contemplated by the enabling act! In the meanwhile the equitable proceedings

were pending, as has been already explained. Learned counsel fenced with one another over nice points of equity practice and pleading. Nine years after the default a decision was obtained in the Circuit Court (65 Fed. Rep. 158) which led to a reference to a master. The amount which was awarded to the lessor by the master was so large that the lessee began to doubt the wisdom of the campaign which it had inaugurated. Finally, however, after about thirteen years of litigation, the wisdom of "taking chances with the law" was vindicated, as the amount of the award was so reduced as to show a balance of advantage in favor of the lessee on the whole transaction. During all this time the stock of the lessor had been rising and falling in the market and its fluctuations offered tempting opportunities for speculation. The litigation had been wearisome and costly. Neither party was wholly satisfied with the result. The decision, regarded as a legal precedent, leaves doubt in the mind of the profession as to how far the Court was influenced by the presence of the lessee's tender of compensation. Would a similar result be reached in a case from which this feature is absent? As long as this question remains open, the decision cannot be said to have made the way plain for the future. Nor is it easy to perceive how a recovery on any terms will hereafter be justified consistently with the conclusion reached in 145 U. S. as to the position of the parties to unauthorized railroad leases.

The decision indeed accords with the Court's theory of corporate power. It is obviously logical to refuse to enforce an agreement if one or both of the parties lacks the necessary contractual capacity. But does not the inconvenience of the conclusion call for a re-examination of the premise? It is submitted that we shall never see our commercial law in a satisfactory state until the courts re-establish the common law doctrine of general capacities,* treating contracts made beyond the limits of chartered activity as contracts prohibited but not void—and leaving the state to punish the disregard of the prohibition, while enforcing the contract between the parties. The enforcement of corporate contracts in spite of objections as to corporate power represents the overwhelming tendency of American decisions. The Supreme Court has given the contrary doctrine a fair trial and the result is, from the practical point of

*For a vindication of the doctrine of general capacities as being the doctrine of the common law, see Pollock on Contracts, Appendix, Note D., "Limits of Corporate Power."

view, a failure. As between the federal courts and a majority of the state courts the advantage is with the former as respects logic and with the latter as respects commercial convenience. The law must, of course, be logical. But shall we sacrifice commercial convenience to logic—or reform our premises so that logic and convenience may coincide?

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