

The liability of the directors and the ultra vires principle under Cyprus Law

General

The general principle under Cyprus Law is that any act beyond the company's legitimate powers (as these are provided in the Memorandum and Articles) is ultra vires and void ab initio. But if a transaction is entered into by a director which is beyond his powers (i.e. ultra vires) but within the powers of the company these can be ratified by a resolution of its members.

The Memorandum and Articles of Association of a company registered in the Republic of Cyprus constitute the constitution of the said company.

The Memorandum of Association states the objects of the company, i.e. it sets out the activities that the company is authorised to carry out. This statement has a twofold function: it affirmatively determines what shall be the powers of the company and it limits and restricts the powers of the company to those thus conferred, save so far as other powers are given by statute.

The Articles of Association contain the internal regulations for the management of the affairs of the company, the conduct of its business and the authority of the directors.

Main Duties of a Director

The directors are agents of the company for which they act and they owe to the company fiduciary duties. These fiduciary duties are mainly to manage the company in accordance with Cyprus Law and the company's Memorandum and Articles of Association and to bind the company vis à vis third parties. However, the directors will be personally liable if any loss is caused to the company because of any illegal or ultra vires acts of them.

The members of the company cannot dictate to the Directors how to manage the business of the company. The only way they can do so is by altering the Articles of Association and thus amending the powers given to the Directors and the Board. The Directors can exercise all the powers of the company except those specifically restricted by the Cyprus Company Law ("Cap 113") and the Articles of Association.

Ultra Vires: Amendment Law 151(1)/2000 to Cap 113 and introduction of new Section 33A

The company is bound vis-à-vis third party by any actions or transactions of its directors even though these may not fall within the objectives of the company except if such actions or transactions are conducted in excess of the powers granted or permitted to these officials by the Law.

The company is not bound towards third parties in case that the company proves that the third party knew that those actions or transaction do not fall within the objectives of the company or it was impossible to ignore this taking into consideration all the relevant circumstances.

The basic section of Cap.113 is s.33A(1), which provides as following:

“the company shall be bound vis-à-vis third parties with respect to the acts or transactions of its officers, even though the said acts or transactions do not fall within the objects of the company, unless such acts or transactions are carried out in excess of the powers provided by law or permitted by law to be provided to the officers in question:

Provided that the company shall not be bound vis-à-vis third parties in the event that such acts or transactions do not fall within the objects of the company, if the third party was aware of the fact that the acts or omissions did not fall within the purposes of the company or that it was not possible to ignore the same under the circumstances.

Provided further that the publishing of the articles of association and of the memorandum of the company shall not, of itself, be sufficient proof that the third party was aware thereof”

Thus it clear that under Cyprus Law the publication of the Memorandum and Articles of Association of the company does not constitute by itself sufficient proof of their knowledge by a third party.

It is important to note thought that s.33A(2) of Cap 113 provides that *“The limitations of the powers of the officers of the Company which generate from the articles of association or from the memorandum or from the decisions of the directors or of the general meeting, may not be used against third parties, even if these have been published.”* Section 33A(2) though should be read and interpreted within the context of s. 33A as a whole.

When can the Corporate Veil be lifted?

Acts which are ultra vires the company are distinguished from acts intra vires the company but outside the authority of the directors. The former the company is incapable of doing whereas the latter it is capable of transacting, but in this type of case the directors have no authority to act on behalf of the company.

Where an act is intra vires the company but outside the authority of the directors two possibilities exist:

- (a) The lack of authority may be evident from the public documents of the company, in which case the doctrine of notice, as set out in s.33A should apply;

- (b) The lack of authority of the directors is not evident from the Memorandum and Articles of Association of the company i.e. where the Articles require the directors to obtain the approval of the members before exercising their specified powers. In such a case, the person dealing with the company cannot gather from the public documents that a director has exceeded his authority. If such a person honestly and without reason for suspicion thinks that the director with whom he negotiates is authorised to act for the company, the company will normally be bound by the director's act under the rule in **Royal British Bank v. Turquand** (1856) 6 E. & B. 327.

The rule in Royal British Bank v. Turquand

Cyprus Law follows the English common law which arises from the case of **Royal British Bank V Turquand** and which provides that the contracting party to an agreement with the company is entitled to assume that the contract has been executed in accordance with the internal regulations of the company and the third party is not obliged to know (unless he/she does know) if there is any inter-company breach or non-compliance with internal rules.

The rule of **Royal British Bank V Turquand** is generally applied when:-

- The person who is relying on the exception does not know or he/she could not know or he/she was not obliged to know that the relevant transaction was not in accordance with the Memorandum
- From the surrounding circumstances of the case it does not appear clearly that the third party should have carried out any search regarding the said matter
- The agreement is not fraudulent
- The decision did not have to be submitted by an agreement to the company Registrar.

Personal Liability of Directors and Result of an Ultra Vires Act

In case where the corporate veil is lifted the Directors of the company that have bound the company by their relevant acts beyond those provided in the Memorandum and Articles of Association of the company are personally liable vis-à-vis the company. The ultra vires acts are void against the company.