GUARANTEE COMPANIES, SPECIALLY
LIMITED COMPANIES AND
PRESCRIBED INCORPORATION

submitted by
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This paper will examine two of the current restrictions on corporations in Alberta, namely the types of corporation which can be formed and the prescribed incorporation of partnerships and associations of over twenty members.

A. Types of Corporations

Section 15(1) of the Alberta Companies Act permits the incorporation of three types of limited liability companies:

(a) A company limited by shares
(b) A company limited by guarantee
(c) A specially limited company

In this section we will discuss the uses of and the need for guarantee companies and specially limited companies in Alberta.

1. Guarantee Companies

Companies limited by guarantee are an alternative to the limitations put on members in a company limited by shares. As defined in s.2(1)(9), a company limited by guarantee:

> Means a company having the liability of its members limited by the memorandum to such amount as the member may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up.

Guarantee companies can be both private and public and can be of two types:

(a) Guarantee companies without a share capital
(b) Guarantee companies with a share capital

(a) Company limited by guarantee--without share capital

This is the usual form of guarantee company incorporated in Alberta and is governed by s. 17. It is required to have a memorandum of association; company names are to end in "limited"; it is to have stated object clauses; and the liability of each member is limited only to a predetermined specified amount upon which he is liable if he is a member within one year after the company has wound up. Under s. 22(1), the articles of association prescribing regulations must be registered with the memorandum thereby requiring the company to have its own special articles and can not merely adopt Table A (unlike share companies which need not register their articles). As well, the articles must state the number of members of which the company will consist(s. 22(2)) so as to enable to registrar to determine the registration fees. The annual return of a guarantee company must comply with the special requirements specified in s. 146(2). The winding up liability of a contributor is specified in s. 146(2). The winding is under no obligation to subscribe up to the amount of his guarantee while the company is a going concern; it is only on the companies being wound up, if a contribution is needed to enable the debts to be met, that any liability on the guarantee arises.

The guarantee undertaken by members of a company limited by a guarantee differs from unpaid share capital in that it is not an asset of the company, but merely a contingent liability of the members to contribute in the event of the company being wound up, and so the amount of the guarantee can not be mortgaged by the company nor can it be increased or reduced by an alteration of the companies memorandum, or by an agreement with the members, or by any process similar to an increase or reduction of share capital. The members primarily responsible for honouring the guarantee are

those who are members of the company at the commencement of its winding up. The persons who have been members within a year before the commencement of the winding up may also be compelled to contribute if the present members are unable to do so or if the companies debts exceed the contributions which the present members can be compelled to make. Members may retire only in the manner set out in the articles, and they may not retire at all unless the articles so provide.

(b) Company limited by guarantee--with a share capital

A company limited by guarantee with a share capital has the same characteristics as a guarantee company without a share capital plus other obligations. Not only is a member under an obligation to contribute a set sum upon the company being wound up, but while the company is a going concern, he is liable to pay up to the nominal amount of his shares as well. Section 21(1)(a) requires a guarantee company with a share capital to register its articles, but does not have to register the number of members of which the company will consist as does the guarantee company without a share capital. This type of company is not very often used in Alberta for the main reason that by having a share capital, one of the main advantages of a guarantee company is eliminated.

Uses of a Guarantee Company

This type of company has long been recognized as having a suitable framework for undertakings which are carrying on a business but do not wish to make a profit for shareholders (recreational organizations, clubs, societies). The organizers of such an undertaking can use the guarantee company to give them the advantages of incorporation such as perpetual succession and limited liability. But a company limited by shares is inadequate for their requirements since the

members are not really intended to "share" in the profits and assets of the company.

Most of the guarantee companies incorporated in Alberta do not have a share capital and are incorporated pursuant to s. 183 and 185 which include companies formed for charitable or recreational purposes, the profits of which are intended to be ploughed back into the organization and which prohibit the payment of dividends to the members. As well, guarantee companies meet the needs of certain specialized groups, such as the Hutterite Colonies of Alberta.

Guarantee Companies in Other Canadian Jurisdictions

None of the new Canadian Corporations Acts, notably the B.C., Ontario, and federal Acts make provision for companies limited by guarantee.[1]

Discussion

There is currently very little written information concerning the usefulness of the guarantee company in the corporate field. When they are used, which is not to often, they are used mainly in recreational organizations under s. 183 and 185.

The major question to be asked in determining the usefulness of the guarantee company in present Alberta jurisdiction is: What major purposes do the guarantee company serve in Alberta which can not be served by means of a company limited by shares?

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[1]. However, guarantee companies still exist in Ontario under the provisions of the old Ontario Act which are still in effect.

At this point it will be useful to note that the various advantages which are available to the guarantee company. It is a kind of corporate vehicle which is suited for an organization of limited or local interest. Flexibility is more apparent in that members can come and go with ease and without liability attaching to them, except when the company is wound up. Guarantee companies are especially suited to the type of organization, such as a learned society, where members may not wish initially to put any money into the concern and where each member has only one vote and one individual can not obtain controlling interest by purchasing a large portion of the shares. In most all of these companies the profits of the group are expressly intended to be put back into the company and not given out as dividends. Yet as a company incorporated under the Companies Act, it is subject to all the disclosure requirements and other limitations imposed by the registrar for the protection of both the company and the public, and conversely garners the protection available to all incorporated bodies under the Act.

The Jenkins Committee felt that a Companies Act should no longer provide for the registration of guarantee companies:[2]

> We agree that if a company is formed with the intention of making pro rata distribution of profit to its members it seems inappropriate that it should be able to register as a company limited by guarantee.

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2. Report of the Company Law Committee, Cmnd. 1749 page 70.

Gower, in the Draft Ghana Code makes provision for companies limited by guarantee but restricts their operation to those companies that do not carry on business for the purpose of making profits i.e. non-profit organizations.

> 10. (1) A company limited by guarantee may not lawfully be incorporated with the object of carrying on business for the purpose of making profits.
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> (2) If any company limited by guarantee shall carry on business for the purpose of making profits all officers and members thereof who shall be cognisant of the fact that it is so carrying on business shall be jointly and severally liable for the payment and discharge of all the debts and liabilities of the company incurred in carrying on such business and the company and every such officer and member shall be liable to a fine not exceeding ₵G5 for every day during which it shall carry on business.
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> (3) The total liability of the members of a company limited by guarantee to contribute to the assets of the company in the event of its being wound up shall not at any time be less than ₵G100.
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> (4) Subject to compliance with subsection (3) of this section, the Regulations of a company limited by guarantee may provide that members can retire or be excluded from membership thereof.
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> (5) If in breach of subsection (3) of this section the total liability of the members of any company limited by guarantee shall at any time be less than ₵G100, every director and member of the company who is cognisant of the breach shall be liable to a fine not exceeding ₵G100.

Howver, it is important to note that Gower contemplates the use of guarantee companies to be extensively used by associations which are essentially societies, bexause Ghana does not have a Societies Act. In a jurisdiction which does have a Societies Act, such as Alberta, Gower's commentary indicates that he would be hesitant of allowing the use of

guarantee companies in a Companies Act[3]:

> In the absence of legislation relating to Friendly Societies, it seems likely that this power to register as a guarantee company will be extensively used by associations which are essentially Friendly Societies and could more appropriately be registered as such. There seems to be no objection to them registering as companies until there is a Friendly Societies Act specifically adapted to their needs; a recognized legal situation is better than none. On the otherhand there is a danger that the Companies Register may become cluttered up with registration of this sort and that the officials of the Registry may find that too much of their time and attention has to be devoted to a type of organization which is not their primary concern.

The Iacobucci Report is not in favour of the guarantee company in a business corporations act[4]:

> We recommend that consideration be given to whether the company limited by guarantee is a necessary form of profit--oriented business organization. To the extent that it is used as a vehicle for non-profit organizations, we recommend that it should not be dealt with in a business corporation statute but rather in a not for profit corporations legislation.

One possible alternative to the maintenance of the guarantee company in the Companies Act would be to transfer the use of

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3. Draft Ghana Code commentary to section 10, page 29 paragraph 8

4. Selected Topics in Canadian Co. Law Reform (Interim Report) p. 4-29

the guarantee company incorporated pursuant to s. 183 or 185 into the Societies Act. However the current features of the Societies Act makes this a prohibitive suggestion. For example, s. 4 of the Act expressly prohibits the purpose of a society to be that of carrying on a trade or business. As well, companies under the current Companies Act enjoy certain other benefits such as extra territorial powers which a Societies Act does not have.

Recommendations

It is apparent from my investigation into the area of companies limited by guarantee that there is a definite need for this kind of corporate vehicle in Alberta. It serves an important purpose in providing the mechanism for the establishment of not for profit corporations as well as charitable and recreational organizations. The structure of a company limited by guarantee, because it does not have share capital, allows these kind of organizations to be run on a one man one vote basis which in most cases is the method by which the company members wish to be governed. Any introduction of share capital could jeopardize this situation by allowing one member to gain a controlling interest in the company and therefore subvert or alter the original objects of the corporation.

However, because these companies are basically non-profit organizations, it is questionable whether they should be governed under a Corporations Act. Both the Ontario and the federal proposals deal only with share companies with the intent of legislating guarantee companies in a separate not-for-profit-corporation law. As indicated in Proposals For A New Not-For-Profit Corporations Law For Canada, incorporation

would be allowed only for[5]:

> A non-pecuniary purpose, that is, a purpose other than for the production of financial profit, gain or benefits for members, directors, officers or any other person that might be associated with the corporation. No part of the assets, income or profit of the corporation can be distributable to or can inure to the benefit of the members, directors or officers of the corporation except to the extent permitted otherwise by statute.

It is hoped that the Alberta legislatures will adopt a similar approach. One way to achieve this result would be to revamp the Societies Act by allowing the incorporation of societies with the object of carrying on a business. However the effect of this would be that the controls surrounding the incorporation of a society would become much more expensive and stringent and would perhaps have a negative influence on the incorporation of smaller societies which require a much less formalized and controlled structure. Therefore it is recommended that Alberta maintain three basic structures for their corporations, namely a company limited by shares to be governed in a corporations act, societies as a they presently exist to be covered in a societies act, and not-for-profit corporations to be dealt with separately in a not-for-profit corporation act in Alberta. Companies limited by guarantee would most appropriately fit into the third category.

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5. Proposals for a New Not-For-Profit Corporations Law for Canada, Vol. 1, 1974 para. 93

2. Specially Limited Companies

As defined in s. 2(1)(33) a specially limited company is:

> A company limited by shares, the memorandum of which provides that no member is to be personally liable for the amount, if any, unpaid on his shares.

The uses of a specially limited company (or N.P.L. Company as it is commonly termed) are restricted to the various facets of the mining industry as per s. 19(b) and has limited powers as detailed in s. 20(3). The Registrar of Companies has indicated to me that that has not been a specially limited company registered in Alberta for many years. Lawyers who incorporate companies in the resource field also indicate that they would not register a company as specially limited.

Whatever the past rationale for the specially limited company was, the use of this kind or corporate vehicle is questionable today. For example, the modern trend in Canadian Corporate Law (as exemplified by the federal act) is to allow for no par value shares which can be issued only when fully paid. This effectively eliminates the use of specially limited companies because of my definition, there shares are not fully paid when issued and are par value shares.

As well, specially limited companies can be deceptive in the eyes of an unknowing public who think that these companies have some sort of special guarantee attached to them which other companies do not. This is something an unscrupulous promoter could easily take advantage of.

The Ontario Business Corporations Act, the federal bill and the B.C. Companies Act do not make provision for specially limited companies. However, the equivalent of a

specially limited company can be incorporated under Part X of the Ontario Corporations Act R.S.O. 1970 c. 89 ss.35-40 which authorizes such companies to issue shares at a discount and protects shareholders from liability for any calls made upon shares beyond the amount agreed to be paid.

The Iacobucci Report indirectly favours the elimination of specially limited companies by recommending that all issued shares be required to be fully paid (seee p. 6-4 of the Interim Report).

It should also be noted that the company law committee minutes of December 27, 1974 discuss the issues of partly paid shares and no par value shares. The minutes indicate that the committee leaned against the notion of partly paid shares although no definite decision was reached. It also appears that the committee reached a definite decision regarding no par value shares. "The meeting approved a provision that there be only no par value shares.[6]" The effect of the decisions regarding no par value shares and partly paid shares will have a definite effect on the future existence of the specially limited company.

Due to the fact that specially limited companies are not presently used in Alberta plus the fact that there use is limited because of the business prohibiting effect of the restrictive objects, it is recommended that the specially limited company be eliminated in the Alberta Companies Act.

B. Prescribed Incorporation

> 7(1) No company, association or partnership consisting of more than

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[6]. See the Company Law Committee Minutes, Dec. 27, 1974, page one and two.

20 persons shall be formed for the purpose of carrying on or shall carry on any business that has for its object the acquisition of gain by the company, association, or partnership, or by the individual members thereof, unless it is registered as a company under this Act, or is formed pursuant to some Ordinance or some other Act.

(1.1) Subsection (1) does not apply to a partnership composed of

(a) persons registered under The Medical Profession Act where the partnership is formed to practice medicine, or

(b) active members of The Law Society of Alberta where the partnership is formed to practice law, or

(c) members of the Institute of Chartered Accountants of Alberta where the partnership is formed to practice accountancy.

(2) The participation of an aggregation of persons in an agreement for

(a) the development and production of a mineral within, upon or under a number of holdings, or in any specified stratum or strata within the holdings, without regard to the boundaries of the separate holdings, or

(b) the implementing of a program for the conservation of a mineral, or for the co-ordinated management of interests in the mineral

shall not be deemed to form a company, association or partnership within the meaning of subsection (1) if a copy of the agreement is submitted to the Minister and approved in writing by him.

Section 7(1) of the current Alberta Companies Act

requires every partnership or association of over 20 persons to be incorporated and registered as a company under that Act. There are some express exceptions to this requirement and they are listed in s. 7(1.1)--members of the legal profession, the medical profession and chartered accountants. As well, an aggregation of persons formed for a unit operation of minerals may be exempted from s. 7 by virtue of s. 7(2) but the agreement must be approved by the Minister in writing.

It appears that the main rationale for this restriction is that the legal regulations applicable to partnerships and associations are much laxer than the regulations for a company under the Companies Act. It is thought that there is a definite need to regulate and control large commercial concerns and the protections afforded under company law legislation are more desirable and more effective than the safeguards provided under partnership or other similar legislation.

Another possible rationale can be garnered from this statement from Gower:[7]

> The only restraint on their (member of a partnership) freedom of choice is that if their number are too great for that mutual trust appropriate to a partnership, they must form a company.

Neither the Federal Act nor the Ontario Act have such a restriction on partnerships or associations. However the British Columbia legislation contains an even more stringent section regarding prescribed incorporation:

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7. L.C.B. Gower, Modern Company Law page 5

> 6.(1) No association or partnership of more than twenty persons formed within the Province shall carry on business unless it is incorporated as a company under this Act or is formed by or pursuant to some other Act of the legislature or, in the case of a partnership consisting of more than twenty persons, the partnership is first authorized by the Lieutenant-Governor in Council to carry on business.
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> (2) Persons who participate in an agreement for
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> (a) developing and producing petroleum and natural gase within, upon, or under a number of holdings, or in any specified strata within the holdings, without regard to the boundaries of the separate holdings; or
>
> (b) implementing of a programme for the conservation of petroleum and natural gase, or for the co-ordinated management of interests in petroleum and natural gas,
>
> do not, for the purposes of this section, constitute an association or partnership if copies of the agreement and of any amendments thereto are filed with the Registrar by the person named as the operator in the agreement.
>
> (3) Every person who participates in an association or partnership that contravenes this section is guilty of an offence.

This section was severely criticised by the British Columbia legal profession when it was introduced.[8]:

> We believe it unnecessary, inconvenient and distasteful to force such large law firms to have to seek special dispensation from the Lieutenant-Governor in Council.

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[8]. Comments on Proposed B.C. Companies Act (Bill 66) Submitted to the Attorney General's Corporate Legislation Committee by the Corporate Legislation Committee of the Canadian Bar Association--B.C. Branch, Oct. 1972 page 4

The Iacobucci Report is on the opposite end of the scale from the B.C. Act and recommends that this type of provision be "reconsidered in the light of modern developments".[9] Unfortunately the report does not indicated what modern developments should influence the reconsideration.

In practice, partnerships of the magnitude envisioned by this section, i.e. over twenty members almost never are created. They are unweildy and do not have enough of the advantages or protections required by businessmen who operate in this commercial society. Only three groups are presently exempted from s. 7--the legal profession, the medical profession and the Institute of Chartered Accountants. However, the argument that the business controls of these groups are laxer and not as tightly controlled as corporations is not true in these three cases in that each of the three groups is regulated by its own set of legal standards, such as Legal Professions Act, which provides complete and complex controls on the business activities of these groups.

The alternatives available in the issue as to whether prescribed incorporation should be maintained are:

(1) eliminate prescribed incorporation (as per the Iacobucci recommendations, and the federal act)

(2) retain prescribed incorporation in its present from

(3) Retain prescribed incorporation but exempt professions whose business practices are governed through

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[9]. supra, no. 4 at page 2-18

another statute or regulation.

(4) Retain prescribed incorporation but allow for some type of professional incorporation.

It is recommended that for the reasons noted above, prescribed incorporation should be retained. However there is undoubtedly a need to exempt professional groups such as lawyers, who are currently prohibited from incorporating in Alberta. These groups often require twenty or more partners to carry on their business. As well, their business practices are stringently controlled by other legislation. It should be noted that some professional groups such as engineers and architects are now allowed to incorporate (and a large number of them have done so). For the same reasons as noted above, prescribed incorporation should continue to apply to them as well. If and when professional incorporation is contemplated in Alberta, the effectiveness of prescribed incorporation for those groups will at that time have to be re-evaluated and adapted.

As for the exemption noted in s. 7(2) regarding an aggregation of persons in the resource area, I could not fin any good reasons for altering this subsection. It was instituted at the istance of the oil industry who recieve certain tax advantages by using "joint ventures" instead of partnerships in research and development schemes. Therefore it is recommended that s. 7(2) be retained.