

Corporations Without Share Capital

R. J. CUDNEY *

Toronto

During recent years in Canada there has been a marked increase in the number of incorporations without share capital. The increase is due, I believe, partly to the growth in population and partly to the fact that with the development of the country certain undertakings have become so extensive that incorporation is advantageous and, in many cases, necessary. The increase in the number of corporations without share capital indicates that the conducting of many types of organization through the medium of a corporation has definite advantages over conducting them as unincorporated bodies. It has become apparent also that there are more advantages to be gained in conducting certain undertakings as corporations without share capital than as corporations with share capital. Accordingly, the study of corporations not having share capital is becoming of increasing importance to the Canadian lawyer.

Nature of Legislation

The Dominion Parliament and the legislatures of all the provinces have enacted legislation on corporations without share capital. In the Dominion Companies Act and the Companies Acts of some of the provinces there is a special part on them. In some provinces corporations without share capital are the subject of a separate Act. The Dominion Act provides that non-share corporations may be incorporated under it only if the objects of the corporation are to be carried out in more than one province. If the undertaking is to be purely local in nature and confined to a particular province, incorporation should be obtained in that province.

* R. J. Cudney, K.C., Deputy Provincial Secretary, Ontario. In succeeding pages is reproduced an address delivered by Mr. Cudney to the Section on Commercial Law of the Canadian Bar Association on September 12th, 1951, during the Association's Thirty-third Annual Meeting.

The objects of corporations without share capital cover a wide field and are extremely varied, including those of a charitable, educational, religious, philanthropic, scientific, artistic, social and athletic nature. Community centres, agricultural societies, social clubs, service clubs, charitable foundations and religious and educational institutions may be incorporated without share capital.

Generally speaking, non-share corporations are conducted without pecuniary gain to their members and it is so provided in their act or instrument of incorporation. In the very nature of the undertaking of most non-share corporations, the members do not receive dividends or other monetary gain. For example, a charitable or hospital corporation exists for the purpose of benefiting the community generally and not to pay dividends to its members. The members of a club look for a recreational and not a monetary benefit from their membership. But it is not true that non-share corporations are never conducted for pecuniary gain to their members. For example, some of the provinces have legislation providing for co-operative corporations without share capital as well as with. A co-operative corporation without share capital does exist for the pecuniary gain of its members either through the declaration of dividends or through the marketing of products or the purchase of supplies at a financial saving to the members. Certain insurance plans also, such as mutual benefit societies, employee mutual benefit societies and fraternal societies, may be incorporated without share capital. The members of this type of insurance corporation do receive pecuniary benefits. Alberta, Nova Scotia and Newfoundland have legislation providing for the incorporation of companies without share capital which may carry on for gain to their members. These companies may pay dividends and appear to be able to carry on, to all intents and purposes, the same business, and are subject to the same conditions, as ordinary commercial companies, the only difference being that they have members rather than shareholders.

It is not true either that corporations designed to operate without profit to the members are always incorporated without share capital. The Saskatchewan, Alberta and Newfoundland Companies Acts provide for the incorporation of a limited company—that is, a company with share capital—for promoting art, science, religion or other similar purposes, the profits of which are applied in promoting the objects. The declaration of dividends in this instance is prohibited. This type of company has share capital and yet is non-profit in nature. The word "Limited" is

not required in its corporate name and it is exempt from one or two of the other requirements applicable to joint stock companies.

Advantages of Incorporation

A corporation without share capital has certain advantages over an unincorporated organization. Incorporation creates an organization more definite and permanent than an unincorporated group of individuals. The Interpretation Acts of the Dominion and Ontario, and legislation respecting corporations in force in the other provinces, provide that a body corporate shall have the power to sue and be sued, to contract and be contracted with in its corporate name, to have perpetual succession and to acquire and hold personal property and moveables. The legislation also provides that the individual members of the corporation are exempt from personal liability for its debts and obligations.

On the other hand, an unincorporated organization is not recognized as having any legal existence apart from the members of which it is composed. It cannot enter into contracts or sue or be sued in its own name. Even if the unincorporated association has by inadvertence entered an appearance, the appearance as well as the writ may be treated as a nullity. It is true that a representative action may be brought by or against one or more of the members on behalf of all the members, where all members have a common material or financial interest, which must be the same and not merely a similar interest. But the representative action is infrequently allowed by the courts and it is less satisfactory than an action by or against an incorporated group.

An unincorporated organization cannot hold real estate in its own name but only through trustees. Often this is inconvenient since trustees may die or resign and may have to be replaced. On the other hand, an incorporated body which has perpetual succession and which exists separate and apart from its members may hold real estate in its own name. Sometimes also organizations, unless incorporated, encounter difficulties in entering international tournaments. Some athletic leagues operating nationally or internationally provide that incorporation of a club or association is necessary for admission to the league.

The members of an unincorporated association may be liable for its debts and obligations. In contract, this liability of the members depends upon the ordinary principles of agency. The members of an unincorporated association may be liable on contracts entered into by the trustees or other agents, either because the contracts are within the scope of the authority given by the rules,

or because, though they are beyond the scope of the authority, the members sought to be made liable can be shown to have sanctioned or subsequently ratified the particular transaction, or to have held out the persons entering into them as authorized to do so.

The question of how far the members of an unincorporated organization are liable in tort for the wrongful acts and omissions of the trustees, officers or servants is one on which there is practically no authority. In principle, the liability of the members of an unincorporated association would seem generally to depend upon whether the actual wrongdoer stands in the relation to them of an agent or servant and, if so, whether at the time of the wrongful act or omission he was acting within the scope of his express or implied authority or within the course of his employment. The members of an incorporated association are exempted from any liability for its debts and obligations: in a share capital company the liability of the shareholders for the obligations of the company is limited to the amount unpaid upon their shares, but in a corporation without share capital the members are exempted absolutely from any liability.

Incorporation Without Share Capital and With Share Capital

Incorporation without share capital has certain advantages over incorporation with share capital. In some cases an undertaking, for example, a golf club, may be incorporated either with or without share capital. A few years ago it was customary to incorporate golf clubs with share capital. Over the years, shareholders die or lose interest and it is not uncommon in some golf clubs for less than twenty-five per cent of the shareholders to take part in the club's activities. The other seventy-five per cent are not interested and, in many instances, cannot be found. Yet it is necessary to send notice to them and, generally, to treat them like active shareholders. As has sometimes happened, when the real estate becomes of value for subdivision purposes, promoters begin to buy up the shares from estates and from disinterested shareholders; and when, through the purchase of sufficient shares, the control of the club has been gained, the real estate is sold and the club is dissolved. In recent years the tendency has been therefore to incorporate clubs as corporations without share capital, and a great many existing clubs with share capital have reorganized, adopting a non-share form of incorporation.

A golf club without share capital is financed by the issue of bonds or debentures rather than by the sale of shares. A membership in a non-share corporation can be made non-transferable, so

that it lapses and ceases to exist on the death of a member. The by-laws can provide that the membership shall lapse also upon the non-payment of annual membership dues. In this way the membership in the club is kept active and the possibility of other interests acquiring control is obviated. Another advantage of incorporating without share capital arises in connection with the expulsion of members. While the cases are not quite clear, it would seem that a non-share corporation, if its by-laws or articles so provide, may expel a member for any cause — an advantage in a club when a member does not abide by its rules. In a club with share capital there is no direct way in which a shareholder can be expelled.

Non-Share Corporations in Ontario

In the time at my disposal, I am unable to deal with the laws of all the incorporating jurisdictions in Canada on non-share corporations. I should like to refer particularly to Ontario corporations, with some reference to those incorporated elsewhere. In what follows it must be kept in mind that under the Ontario Act (and, I understand, in Manitoba) the word "corporation" includes both corporations with and without share capital. The word "company" means only companies with share capital.

In Ontario corporations not having share capital are incorporated under the Companies Act by letters patent. The granting of letters patent is within the discretion of the Lieutenant-Governor and is withheld when incorporation is considered to be not in the public interest. Application for incorporation is by way of petition of three or more persons at least twenty-one years old. The Provincial Secretary's Department requires that the applicants be persons who will continue to be members after the organization meetings and not merely "office incorporators" as is permitted in the case of joint stock companies. Often the application is referred to other interested departments of government, who may require information about the persons who will actually be the members.

The petition must be accompanied by a memorandum of agreement in duplicate. The Act requires that this memorandum set out regulations on the control and management of the corporation and provides that the petitioners may adopt all or any of the regulations in Form 4 of the schedule to the Act or substitute others. The regulations contained in the memorandum of agreement are transcribed into the letters patent. In practice, it has been found advisable to adopt a short form of memorandum of agreement rather than the long form contained in Form 4 to the

Act. This short form provides that the regulations contained in Form 4 shall apply to the corporation but that the directors may enact by-laws to vary, repeal or amend them. In this way the constitution of the corporation becomes largely a matter for the by-laws and may be changed at any time by by-law without the necessity of obtaining supplementary letters patent. If the long form memorandum of agreement set out in Form 4 is used, it is transcribed into the letters patent and can only be changed by supplementary letters patent. I would therefore recommend the adoption of the short form memorandum of agreement and, indeed, it is almost invariably used in preference to the long form.

By-Laws

If the short form memorandum of agreement is used, it is transcribed into the letters patent and the directors have the power to make by-laws respecting:

- (a) the admission of members and the election or appointment of directors, trustees and officers;
- (b) the time and place of holding and the calling of meetings of members, trustees and directors, the requirements as to proxies and the procedure at and the conduct of meetings;
- (c) the payment of officers and employees; and
- (d) the control, management and conduct of the affairs of the corporation.

Usually the short form memorandum, and likewise the letters patent, provide that any by-law and every amendment or repeal of a by-law, unless in the meantime confirmed at a general meeting called for that purpose, has force only until the next annual meeting. In default of confirmation there, the by-law ceases from that time to have force, and no new by-law to the same or like effect has any force until confirmed at a general meeting. If the applicants desire, the letters patent may provide that no new by-law whatever, or any repeal or amendment of any by-law, shall have any force or effect until it has been confirmed by the members in a general meeting. This clause gives the members more control over the actions of the directors, but it is unusual.

In Ontario the by-law and amendments do not need to be filed with or approved by the Provincial Secretary. Under the Dominion, Prince Edward Island, Quebec and Manitoba Acts, the by-laws and amendments are required to be approved by the Minister before they are acted upon. In Nova Scotia, Saskatchewan, Alberta, British Columbia and Newfoundland the articles or by-laws must be filed with the Registrar of Companies.

Under the Dominion, Ontario, Quebec, Manitoba and Prince Edward Island Acts, any provisions which may be adopted in the by-laws may be included in the letters patent. From time to time in Ontario, although it is not usual, the applicants desire to have special conditions, relating for example to eligibility of members, classes of membership and restrictions on the number of members, included in the letters patent rather than to leave them to the by-laws. If the conditions are left to the by-laws they may be readily changed by by-law; if embodied in the letters patent they may be changed only by supplementary letters patent.

Name

The name of a corporation not having share capital does not include the word "Limited", but, if the applicants wish, the word "Incorporated" or the abbreviation "Inc." may be the last word of the name. Speaking personally, I think that "Incorporated" could be used more frequently. A non-share corporation may not have the word "company" in its name since "company" is defined under the Act as meaning a company with share capital. The name may include some such word as "Corporation", "College", "Club", "Association", "Society", "Foundation", "Community Centre", and usually does, but there is no departmental requirement that it must. For example, we have granted to a non-share corporation a name like Green River Island.

The name of a non-share corporation may not be the same as, or so similar to, that of some other existing organization, incorporated or unincorporated, as to be likely to cause confusion in the minds of the public. And the name should not be one which is objectionable upon any public ground. For example, a name may not be satisfactory if it suggests that the corporation has some governmental or municipal connection or sponsorship. For this reason, the Department is reluctant to allow in corporate names such words as "Board", "Council", "Bureau" or "Commission". A name such as "London Citizens' Welfare Bureau" would not be granted without the consent of the City of London.

The membership of the corporation should be representative of the group indicated by the name. For example, the name "Hamilton Retail Tobacco Distributors Association" would not be granted if only ten per cent of the retail tobacco distributors in Hamilton are expected to become members. In accordance with a departmental rule, this name could not be given unless at least seventy-five per cent of the retail tobacco dealers in Hamilton are to be members of the corporation.

Objects

The objects of a non-share corporation to be conducted without pecuniary gain to its members should not be those ordinarily found in the letters patent of commercial companies. For example, the objects of a non-profit corporation could not begin with the clause "to carry on the business of printers". A non-profit corporation may wish, however, to carry on business incidental to its main objects. For example, an agricultural society may desire to conduct a printing and publishing business for the purpose of disseminating information to its members and to the public. In that case the objects might read:

- (a) to promote interest in and the study of agriculture generally; and
- (b) for the purposes aforesaid, to carry on printing and publishing and to sell and distribute literature.

Under section 27 of the Ontario Act a non-share corporation has the power to hold such real estate as is necessary for its purposes. Under section 78 the directors have power to make by-laws for borrowing money and for issuing bonds and debentures, and under section 82 they have the power to give mortgages. It should be noted, however, that the incidental and ancillary powers under section 23, which apply to companies with share capital, are not applicable to corporations without share capital. This should be kept in mind when drafting the objects of non-share corporations for it may be advisable in some cases to include certain secondary powers which need not be included in the letters patent of share capital companies. For example, it is desirable in some undertakings to include the power to invest moneys of the corporation not immediately required for its purposes in such investments as the directors may determine. Sometimes the applicants wish to limit the scope of these investments to those authorized by the Trustee Act or the Canadian and British Insurance Companies Act.

It is usual to include in the objects of a non-share corporation the power to accept gifts, donations, legacies, devises and bequests.

Almost without exception, the purposes and objects end with the clause "To do all such other things as are incidental or conducive to the attainment of the above objects". This object clause is wide and often is very important to the corporation.

Capital

A corporation without share capital cannot, of course, finance by the sale of shares. It may, however, raise capital by other means, notably by membership entrance fees, annual membership dues,

donations or borrowing, or by the issue of bonds or debentures. The bonds or debentures may be secured by a mortgage upon the assets of the corporation. Often the by-laws provide that as a condition to becoming a member a person shall subscribe for a bond or debenture of the corporation for a specified principal amount. There is no limit in the Companies Act on the amount of capital which may be raised in any of these ways.

Directors

If the short form memorandum of agreement is adopted, the letters patent provide that the directors of the corporation shall constitute the committee of management of the corporation. The letters patent also provide that the directors may enact by-laws respecting the election and appointment of the directors and the control, management and conduct of the affairs of the corporation. Accordingly, the control and management of the affairs of the corporation is in the hands of the directors. They have the sole power to initiate, repeal and amend by-laws. The function of the members is largely to confirm or reject in general meeting the by-laws submitted to them by the directors.

The Act provides that at least three of the applicants for incorporation shall be the provisional or first directors. The by-laws may increase or reduce the number of directors. If the by-laws do not so provide, it would appear that under Form 4 the members in general meeting can by resolution increase or reduce the number of directors. While it is not definitely stated in the Act, it would seem that the number of directors can never be reduced to less than three.

Under Form 4 a resolution signed by all the directors is as valid and effectual as if it had been passed at a duly called general meeting of the directors. This rule is applicable only to corporations without share capital. There are cases to the effect that companies with share capital must hold a meeting of directors in order to pass a valid resolution and cannot do so merely by having all the directors sign it.

The sections in the Ontario Act relating to directors' liability apply only to the directors of companies having share capital. It would appear therefore that the liability of directors at common law applies to directors of corporations not having share capital.

The affairs of a corporation must be managed by its members and not by an outside authority. Therefore, with one slight exception, directors must be elected from among and by the members in general meeting and cannot be designated by any other body.

Sometimes this rule causes practical difficulties. For instance, a hospital corporation not having share capital is in the nature of a community undertaking and annual financial contributions to it are usually made by the municipalities in the area it serves. These contributing municipalities, because of their financial assistance, should have some part in the management of the hospital. They may wish to appoint annually certain members of the board of directors who will act on the board as the representatives of the municipality. In view of the rule of law that corporations must manage their own affairs, a municipality could not legally appoint directors. The same result may be achieved indirectly, however, by restricting the qualification of those eligible for membership to persons approved by the municipalities. For example, the City of X, the Village of Y and the Township of Z may wish to establish a hospital for the benefit of their residents and may decide to incorporate a hospital corporation without share capital for the purpose. The City of X will contribute annually one-half of the financial support and the Village of Y and the Township of Z will each contribute one-quarter. The letters patent in this instance may provide that the number of members shall not exceed twenty, ten of whom shall be approved by the Council of the City of X, five by the Council of the Village of Y and five by the Council of the Township of Z. These members are not admitted to membership by the municipalities. They are admitted by the directors of the corporation, but the approval of the appropriate municipal councils is a condition precedent to eligibility. The letters patent go on to provide that there shall be a board of eight directors, four of whom shall be elected by and from the ten members approved by the City of X. Two other directors of the board of eight will be elected by and from among the five members approved by the Village of Y. Likewise, the two remaining directors of the board will be elected by and from among the five members approved by Township Z. This plan of organization provides a practicable means by which the municipalities who are financing the hospital have a measure of control in its operations in proportion to their financial contributions. At the same time, the plan provides that the members are admitted by the directors and the directors are elected by the members, in accordance with the rule that a corporation cannot be managed by any outside authority.

Members

A corporation without share capital is composed of members rather than shareholders. The Ontario Act does not limit the number of

members. The letters patent or by-laws may provide a limitation but seldom do. No limit is placed on the number of members either in the Dominion Act or in the Acts of the other provinces, with the exception of Alberta. The Alberta Companies Act provides for what is called a private company not having share capital. Such a company is for pecuniary gain, although it is without share capital and has members rather than shareholders. The membership is limited to fifty persons.

The by-laws or, if the applicants desire, the letters patent set forth the conditions for the eligibility of members. It may be provided that only persons of a particular trade or profession, or only persons residing in a particular area, are eligible. The conditions of membership should be clear and easy of interpretation. For example, the by-laws should not provide that only persons residing in the St. Catharines district shall be eligible, for it would be difficult to determine where the district begins and ends. It would be better to provide that only persons residing in the City of St. Catharines and in the Townships of X, Y and Z shall be eligible. While sometimes it is unwise to have too small a membership, the number of members can also be too large, and hence unwieldy. For instance, the by-laws of a charitable corporation may provide that any person who gives \$1.00 to the corporation shall be admitted as a member. If the by-laws do not go on to provide that membership lapses if the annual dues are not paid, the members of even a small undertaking might soon be numbered in the thousands. These members have to be sent notices and a problem is also created sometimes, which I shall mention presently, if the charitable corporation is ever wound up. I would suggest therefore that the by-laws governing conditions of membership be drawn so as to avoid too many members.

Usually members are admitted by resolution passed by the directors. It would seem, however, that the directors may pass a by-law providing that the incumbent for the time being of a certain office shall ipso facto become a member of the corporation and that upon ceasing to hold office he ceases to be a member. For example, the by-laws of an art gallery could provide that the principals for the time being of certain art schools should be members of the gallery. A by-law of this sort is advisable in certain cases since it provides for members who are likely to be interested and active. It has the added advantages of providing for a changing membership and guarding against what could become a self-perpetuating body.

Under the Ontario Act, and under the legislation in most of

the other provinces, membership in a non-share corporation may be either transferable or non-transferable. Under the "Societies Acts" of British Columbia and Alberta membership is not transferable. In Ontario, almost without exception, the letters patent provide that the interest of a member shall not be transferable and shall lapse and cease to exist upon his death or when he ceases to be a member by resignation or otherwise in accordance with the by-laws from time to time in force. It is very seldom that membership is made transferable. The fee for incorporation is \$100.00 if membership is transferable and \$20.00 otherwise.

Membership, it would seem, may be divided into different classes. Classes may be provided for either in the by-laws or if the applicants desire in the letters patent. For example, provision may be made for honorary members, life members and ordinary members. While ordinarily each member has one vote, it would seem that different voting rights may attach to different classes of membership.

Non-Profit to Members

In Ontario non-share corporations, with the exception of co-operatives and certain insurance plans, are not for profit or gain to their members. The petition for incorporation provides that the corporation shall be carried on without gain and that any profits or other accretions shall be used in promoting its objects. This provision is transcribed into the letters patent. The corporation may not pay dividends therefore and no member may receive any profit or gain. For example, the subscribers to a pre-paid medical or hospital plan cannot be members of the corporation which provides the plan since the benefits would be in the nature of gain. For the same reason it would seem that no person in receipt of a salary from the corporation should be a member.

Because of this non-gain clause, there is some question whether in the event of the dissolution of the corporation the surplus assets may be distributed among the members or whether the assets should be donated to undertakings having cognate objects. The non-gain clause could be interpreted as prohibiting any distribution of assets among the members. But section 31 on surrender of charter and Part XIV on voluntary winding up contemplate a rateable distribution of assets among the shareholders or *members*. In order to reconcile these different provisions of the Act it could be argued that the non-gain clause does not prohibit a distribution of assets among the members upon dissolution but does permit a distribution at least to the extent of the moneys

actually paid by the members to the corporation. However, if it is desired that the members will participate in a distribution of assets, the original financing of the corporation, in order to avoid any doubt, should be by an issue of bonds rather than by donations. A bond issue creates a relationship of creditor and debtor between the member and the corporation. The terms of the bonds need not be too onerous to the corporation. Sometimes, the bonds carry no interest and are payable only upon dissolution.

On the other hand, if it is desired that the members will not participate in any distribution of assets but that the assets will be given to cognate objects, the following clause may be included in the letters patent:

That upon the dissolution of the corporation any assets remaining after the payment and satisfaction of the debts and liabilities shall be transferred to an organization or organizations having cognate or similar objects.

The by-laws may provide also that persons, upon admission to membership, shall be required to sign a waiver authorizing the transfer of assets upon dissolution to cognate or similar objects.

An Enticing Study

The reason why the study of at least the principles of law ought to form part of any scheme of liberal education is because the law is the very foundation of human society, the very basis on which our civilization is founded. Has it ever occurred to you to inquire how it is that the millions of human beings who crowd our cities and populate our rural areas manage to live together at all? If you think of them each individually compact of ambitions, passions, rivalries, and jealousies and all in competition for the necessities and the luxuries of life, and of the endless opportunities for conflict which their daily contacts present, how comes it, you may well ask, that we all go about our several vocations undisturbed and live our lives in peace and freedom? The main reason is that by the slow growth of law the warring instincts of mankind have been accommodated and subdued to order. We are not conscious of this influence regulating our lives and we have grown so accustomed to its operation that we no more think of it than we do of the air we breathe. But it is true all the same that it is as essential to our social well-being as the air is to our lungs. An eminent legal friend of mine once inelegantly compared our legal system to our main sewerage. We spend our days oblivious of its beneficent action until something goes wrong with it and then we realise from the unsavoury consequences how much of our comfort depends upon it. (Rt. Hon. Lord Macmillan, *Law and the Citizen*, from *Law and Other Things*)