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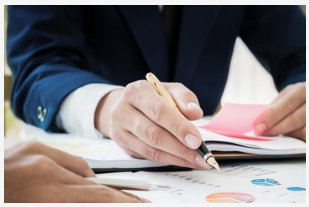
What secured lenders need to know when taking a pledge of shares in Alberta or British Columbia ULCs



NOV 15, 2023 5 MIN READ

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This article is intended to provide a high-level overview of key points of interest to a lender dealing with an unlimited liability company (ULC) formed under the laws of British Columbia or Alberta. We also highlight areas of concern for secured lenders and collateral agents with respect to a pledge of ULC shares.

What is a ULC?

A ULC is a type of corporate entity which exists under certain corporate statutes in Canada. British Columbia, Alberta and Nova Scotia are the only provinces that currently provide for a ULC regime.

Generally, a ULC, like a corporation, is a distinct legal person and has the capacity to contract, own assets and incur liabilities and obligations. Unlike a corporation, however, the liability incurred by a ULC flows to the shareholders. Secured lenders taking a pledge of ULC shares from a ULC shareholder should therefore consider whether such lender's actions, in its capacity as secured party under a share pledge agreement and possession of such shares accompanied by a share transfer power, may cause the lender to be characterized as a "shareholder," and be aware of any liability that may flow as a result.

General approach to a ULC share pledge

A lender who takes a pledge of shares of a ULC will want to take all available steps to reduce the likelihood that (1) the lender would be considered to be a shareholder by the mere fact that it is a pledge holder; and (2) a lender would automatically be deemed to be a shareholder without clear and conscious action on its part prior to becoming a shareholder (i.e., the lender has the opportunity to evaluate the risks and benefits of becoming a shareholder prior to the assumption of any corresponding liability).

A lender should attempt to accomplish the first goal by limiting its rights under the pledge until it enforces on its security following an event of default and should avoid putting the lender in a position where there is an entitlement to registration in the company's records as a shareholder. The second goal could be furthered by establishing clear procedures, requiring positive action by the lender, which must be taken before any new rights arise at

which time the lender would become a registered shareholder.

Shareholder liability in Alberta and British Columbia

Shareholder liability exposure is generally greater in Alberta than in British Columbia. In Alberta, shareholder liability arises when a ULC incurs the obligation, whereas in British Columbia, liability only arises in the event of a liquidation or dissolution.

In Alberta

Under section 15.2(1) of Alberta's *Business Corporations Act* (ABCA), the liability of each shareholder of an Alberta ULC for "any liability, act or default" is "unlimited in extent and joint and several in nature." Accordingly, a shareholder's liability is not limited to such shareholder's investment in the ULC, but rather the total amount of the ULC's obligation. Note there are some minor exceptions for statutorily imposed liabilities under section 15.2(1).[1] However, these exceptions would not capture contractual liabilities resulting from the incurrence of debt or a guarantee.

Former shareholders are liable for debts, acts and defaults even after the shareholder ceases to hold shares in the ULC *unless* (a) two years have elapsed from the date on which such former shareholder last ceased to hold shares in the ULC, subject to any immunity arising out of the *Limitation Act* (e.g., persons under disability, mistake, delay and laches, etc.);[2] or (b) the act, liability or default of the ULC did not exist at the time the former shareholder last ceased to be a shareholder of the ULC.[3]

In British Columbia

Under section 51.3 of British Columbia's *Business Corporations Act* (BCBCA), current and former shareholders of a ULC are jointly and severally liable to contribute to (1) the ULC's assets from the start of liquidation until its dissolution; and (2) payment directly to its creditors following dissolution. Accordingly, shareholder liability in British Columbia is more narrowly limited in time to the liquidation or dissolution of a ULC, whereas liability in Alberta arises once the ULC incurs the obligation.

Former shareholders will not be held liable unless it appears to a court that the current shareholders are unable to satisfy the debts and liabilities of the ULC.[4] In such an event, a former shareholder will still not be held liable if (a) the debt or liability of the ULC arose after they ceased to be a shareholder; (b) in the case of liquidation, they ceased to be a shareholder one year or more before the commencement of liquidation; or (c) in the case of dissolution, they ceased to be a shareholder one year or more before the commencement of dissolution.[5]

Specific things to avoid when taking a pledge

When taking a pledge in shares of a ULC, a lender should not acquire rights that would ordinarily be associated with share ownership. In particular, a lender should avoid obtaining voting or dividend rights prior to enforcement following a default.

However, a lender should assume that once it takes steps to exercise its rights to enforce its security pursuant to a pledge (other than a straight transfer of the shares) or act in any

manner as a shareholder of the ULC or attempts to exercise any rights of a shareholder of the ULC, they may be deemed to be a "shareholder" and subject to liability as a result. Accordingly, a lender would want notice of enforcement prior to proceeding and the opportunity to weigh the benefits and risks associated with potentially being deemed a shareholder.

The following actions are examples a lender should avoid with respect to a pledge of ULC shares:

- making an application to have the pledged shares registered in the lender's name or the name of its agent
- a lender holding itself out to others as a shareholder of a ULC
- a lender receiving dividends or other property from a ULC by reason of it holding the pledged shares
- a lender acting as a shareholder of the unlimited company or to exercise or attempt to exercise any rights of a shareholder, including the attendance or shareholder meetings or voting rights

Please feel free to reach out to a member of our team if you have any questions on the foregoing or would like to discuss in greater detail.

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[1] See *Business Corporations Act* (Alberta), ss. 38(4), 146(7) or 227(4).

[2] *Business Corporations Act* (Alberta), s. 15.2 (2).

[3] *Business Corporations Act* (Alberta), s. 15.2 (3).

[4] *Business Corporations Act* (British Columbia), s. 51.3(2).

[5] *Business Corporations Act* (British Columbia), s. 51.3(2)(a) – 51.3(2)(c).