



GARDINER ROBERTS LLP
Lawyers

Ontario Charities and Not-for-Profit Section

Panel Discussion

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Modernization of Not-for-Profit Corporations Act of Ontario

Gardiner Roberts LLP

Barrister & Solicitors
Scotia Plaza
40 King St. West
Suite 3100
Toronto, ON
M5H 3Y2

Tel: 416-865-6600
Fax: 416-865-6636

www.gardiner-roberts.com



This article was prepared by Clifford Goldfarb. Mr. Goldfarb is Chair of our not-for-profit and charities practice group and can be reached at 416-865-6616 or cgoldfarb@gardiner-roberts.com

The *Ontario Corporation Act* (“OCA”) was the principal corporate law statute in the Province of Ontario from 1907, when it was first enacted, until 1971, when it was replaced for business corporations by the predecessor of the current *Ontario Business Corporations Act* (“OBCA”). The OCA was last substantially amended in 1953 and has had only minor revisions in the intervening years. However, it still remains the principal corporate statute governing the incorporation and status of non-share capital and non-profit corporations (“NFP”) in the Province of Ontario. It is lacking many fundamental provisions found in modern corporate statutes and doesn’t reflect the sophisticated needs of the enormous number of charitable and non-profit corporations which have come into existence in Canada over the past few decades. The other alternative most Ontario lawyers employ for such corporations is the *Canada Corporations Act*, which has a similar history and similar limitations. There is a parallel initiative to replace this Act with Bill C-62, which died on the order paper when the current federal election was called, but is expected to be reintroduced at some point in the reasonably near future.

As part of the ongoing modernization of Ontario corporations law, which has already produced the new *Securities Transfer Act, 2006* and amendments to the OBCA, in 2007 and 2008 the Ministry of Government Services released three consultation papers on “modernization of the legal framework governing Ontario not-for-profit corporations”. Responsibility for this process has since shifted to the Ministry of Small Business and Consumer Services.

The first consultation paper was released on May 7, 2007 and was general in nature. The second was issued on August 22, 2007. This paper primarily related to directors and management of NFP corporations. The third consultation paper was issued February 28, 2008, and focused primarily on membership rights and remedies, audits, by-laws and self-perpetuating boards.

The Business Law and Charities and Not-for-Profit Law sections of the Ontario Bar Association formed a joint working group (the “JWG”) co-chaired by Wayne Gray of the Business Law section and David Stevens of the Charities and Not-for-Profit section. The JWG met on numerous occasions and produced separate responses to each of the three consultation papers, the last of which was delivered on May 23 of this year. These responses have been posted on the OBA website, www.oba.org. Following the responses, the Ministry invited members of the JWG and other organizations which had responded to the discussion papers to participate in a confidential web-based consultation process. The OBA has been strongly supportive of this initiative. A new NFP corporations act will doubtless be of immense value to all Ontarians.

The OCA currently governs some NFPs with share capital, such as social and golf clubs. However, the new statute is intended to apply only to non-share capital NFPs. In



addition, it is not intended to be a regulatory statute. The proposed legislation will deal only with the incorporation and governance of corporations carrying on not-for-profit activities in Ontario. Other legislation exists to regulate the activities of NFPs, particularly charities, including the *Charities Accounting Act (Ontario)*, the *Charitable Gifts Act (Ontario)* and the *Income Tax Act (Canada)*. It is also understood that the new Act will be extended to replace at least some of the special acts that now exclude the OCA. There may also be some transitional provisions for corporations which will no longer have a home in the new Act. Some may end up under the OBCA, but there may be other alternatives, including the *Co-operative Corporations Act*.

The Ministry consultation papers were intended only to raise issues and not to presage any government decisions. What follows, therefore, highlights the major recommendations of the OBA. Since to date the government has not publicly signaled whether it will accept any or all of the OBA's recommendations, this paper is somewhat speculative, but is based on the JWG's best estimate of what the draft Act is likely to contain.

1. First Consultation Paper (May 7, 2007)

The key issues in the first consultation paper had to do with the nature of the proposed legislation. The JWG recommended that the new statute be modeled on a combination of existing statutes, including the Saskatchewan *Non-Profit Corporations Act, 1995*, and federal Bill C-21 (now Bill C-62), as well as model American legislation. The JWG then dealt with the specific issues raised in the consultation paper.

- The first issue was whether there should be incorporation as of right, rather than the current discretionary process. The JWG's unanimous view was that incorporation should be as of right.
- The next issue was one on which the JWG was not unanimous. The scope of the new act is problematical. Should it include all NFPs, including those in which surplus may be distributed to the membership, either during the existence or on the winding-up of the corporation? The JWG suggested that consideration should be given to having such "true membership" corporations (sometimes called "mutual benefit" corporations) governed by another act, possibly the OBCA, leaving only "pure" NFPs under the new act.
- The JWG also recommended that the new act should not limit the purposes for which NFPs can be incorporated. Rather, NFPs should be permitted to be incorporated for any purpose other than the distribution of profit to their members, including commercial activities. However, if true membership corporations are included in the new act, it will be necessary to provide a method of allowing distribution of surplus assets to the members, including separate provisions for true membership corporations, on the one hand, and charities and pure NFPs which cannot make such distributions, on the other.
- The JWG was also divided on whether the new act should contain a classification system, dividing NFPs into categories such as "public benefit", "membership" and "religious", with different default governance and other rules applicable to each category.
- On the issue of capacity of such corporations, the JWG was unanimously of the view that the old doctrine of *ultra vires* should be abolished and that corporations under the new legislation should have the same capacity as corporations incorporated under the OBCA. However, in order to qualify as "charitable" for income tax purposes, NFPs will have to be able to add a provision to their charter restricting themselves to charitable activities.



- The JWG also recommended that directors and officers of NFPs should be subject to similar duties, and entitled to similar defences against liability and indemnification rights as those provided under the OBCA, with some modifications to the standard of care because NFP directors cannot be compensated for serving as such.
- On the issue of financial disclosure the JWG recommended that the level of disclosure, type of financial statements – audited versus some lesser standard – and method of their distribution should be governed by the type of activity, whether the members have any kind of economic interest, as in true membership NFPs, and other factors. Amendments to the *Charities Accounting Act* may be required for this purpose.
- The final issue raised in the consultation paper was members’ remedies, such as compliance orders, oppression remedies and derivative actions. The JWG recommended that most remedies should be selected on an opt-in basis at the time of incorporation, possibly based on the classification of the NFP. The consensus was that some form of derivative action seems to be appropriate for NFPs, while other possible remedies and who should be entitled to them needs further study.

2. Second Consultation Paper (August 22, 2007)

This paper primarily related to directors and management of NFP corporations. The OBA’s specific recommendations included:

- Directors should not be required to be members. Other qualifications required of directors should mirror those applicable to directors of an OBCA corporation.
- The new Act should not impose any maximum number of terms on a director. However, directors must be elected at least every three years.
- Members should be permitted to remove directors by resolution.
- The duties of care and loyalty and the conflict of interest regime imposed on directors and officers of an NFP corporation should mirror the comparable provisions of the OBCA. Likewise, the availability of D&O indemnification and insurance should mirror the OBCA provisions. In particular, the current additional requirements for corporations with charitable objects under the *Charities Accounting Act*, should be removed.
- To expand the pool of strong directors available to NFP corporations, the new Act should shield directors, officers and employees from personal liability except in cases of fraud, self-dealing or failing to act in good faith.

3. Third Consultation Paper (February 28, 2008)

The third and final paper focused primarily on membership rights and remedies, audits, by-laws and self-perpetuating boards. The OBA’s recommendations included:

- Memberships should not be transferable unless otherwise stated in the articles.
- The new Act should include a provision stating that termination of a membership or membership rights must be made in good faith and in a fair and reasonable manner, which would comprise certain minimum specifications to be enshrined (or embellished) in the by-laws.
- By-laws may permit voting by proxy; otherwise, the default rule would be no proxy voting.
- The new Act should allow members to requisition meetings if the requisition is signed by not less than 10% of the members entitled to vote. In addition, members



and directors should be entitled to apply for a court-ordered meeting where the meeting is otherwise impracticable.

- The new Act should allow not less than 5% of the voting members to submit written proposals to the corporation to be included in the notice of the next ensuing annual meeting.
- Subject to limited exceptions, every NFP corporation should obtain an audit. Where the corporation's revenues of the previous fiscal year are less than \$1 million, two-thirds of the voting members may elect to have a review engagement instead of an audit. If the annual revenues are less than \$100,000, two-thirds of voting members could elect to have a compilation report instead of either an audit or review engagement.
- Financial statements or a summary must be made available to members prior to the annual meeting.
- The new Act should provide for compliance orders to ensure that the corporation, and its directors and officers, comply with the duties set out in the new Act and the corporation's articles and by-laws.
- The new Act should provide for a statutory derivative action modeled on the OBCA, which requires leave of the court.
- There should be no dissent and appraisal remedy, i.e. a statutory mechanism entitling members to demand payment of the fair value of their interests upon certain fundamental changes.
- The new Act should certainly include an oppression remedy for true membership corporations. It is much more debatable whether the new Act should include an oppression remedy for charitable and other NFP corporations where the articles contemplate no such distribution of surplus assets to members.

Some Speculation

It is probably safe to expect that the draft Bill, when it appears, will look and feel like a non-profit version of the OBCA. That is, it will probably follow the same arrangement of topics, and will incorporate OBCA language whenever there is no good reason to deviate from the provisions of the OBCA. Not only will this give some consistency to Ontario corporations law, it will allow lawyers who do not specialize in the non-profit area to more easily work with the statute. We expect to see a statute that facilitates the incorporation of NFP's and provides a minimal framework, with some default rules, as well as the ability to opt-out of anything not deemed compulsory. We are hoping that the OBA recommendations relating to true membership corporations and other types of NFP's will be included, and that the additional rights and remedies given to members of the former will reflect the realities of the different types of NFP's.