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May 23, 2008

Ministry of Government Services
Policy Branch
777 Bay Street
5th Floor, Suite 501
Toronto, ON
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Dear Sirs/Mesdames:

Re: Submission of the Ontario Bar Association ("OBA") to the Ministry of Government Services on the February 28, 2008 Phase III Business Law Modernization Consultation Paper

We are pleased to enclose the OBA's submission on the above Consultation Paper, which was prepared by the Joint Working Group of the OBA Corporate Law Subcommittee, Business Law Section and the Charity and Not-for-Profit Law Section.

As stated in our enclosed submission, replacing Part III of the *Corporations Act* (Ontario) with a modern statute governing non-profit corporations is an important initiative and we strongly urge the Government to stay on course to implement the new legislation in 2009.

Yours truly,

Greg Goulin, President
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Wayne D. Gray, Co-Chair
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Submission of the Ontario Bar Association to the Ministry of Government and Consumer Services

Consultation Paper #3 Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations

Submitted on *May 26, 2008*

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Table of Contents

INTRODUCTION **3**

MEMBERSHIP **4**

CORPORATE FINANCE **18**

OTHER **23**

CONCLUSION **25**

SCHEDULE A: LIST OF OBA JOINT WORKING GROUP ("JWG") MEMBERS **26**

INTRODUCTION

This submission (the "**Submission**") is written in response to the third and final consultation paper (the "**Consultation Paper**") published by the Ontario Ministry of Government and Consumer Services ("**MGCS**") on February 28, 2008. The Submission was prepared jointly by the Corporate Law Subcommittee ("**Subcommittee**"), Business Law Section, Ontario Bar Association ("**OBA**") and the Charity and Not-for-Profit Law Section (the "**Charity Section**"), OBA.

This Submission is further to the submissions of the joint working group ("**JWG**") of the Subcommittee and the Charity Section in response to the first and second consultation papers submitted to MGCS pursuant to letters dated September 28, 2007 (the "**First Submission**")[1] and February 22, 2008 (the "**Second Submission**")[2] respectively (together with this Submission, the "**OBA Submissions**").

As stated in the First Submission, the JWG provides the combined viewpoints of lawyers with extensive experience advising not-for-profit ("**NFP**") organizations and lawyers with extensive experience in corporate law and corporate law reform. The members of the JWG who participated in this Submission are listed in Schedule A.

The terms used but not otherwise defined in this Submission are defined in the First Submission.

[1] Available on the OBA's website at: http://www.oba.org/en/pdf/OBA_Phase3_bus_law_modernization_Paper1.pdf
[2] Available on the OBA's website at: http://www.oba.org/en/pdf/OBA_Phase3_bus_law_modernization.pdf

MEMBERSHIP

When considering the issues and options for membership rights and remedies, it is important not to analogize too closely to the rights and remedies accorded shareholders under business corporation statutes such as the Ontario *Business Corporations Act*[3] and the *Canada Business Corporations Act*.[4] Shareholders of business corporations have an economic interest in the corporation that drives their rights and remedies and makes maximization of shareholder welfare the overarching principle of the OBCA/CBCA. Other than for true membership corporations[5] (*i.e.* certain NFP corporations such as membership-owned golf clubs, tennis clubs, curling clubs and other non-share social clubs the net assets of which are distributable to members on a liquidation or dissolution), members typically have a limited economic interest in the profits and residual assets of an NFP corporation. Thus, the dynamic underpinning shareholder rights and remedies in business corporations is not the same as it is for members of NFP corporations. Nor is the same economic incentive to enforce shareholder rights and remedies at work in the case of members of NFP corporations. Thus, the proposed new Act governing NFP corporations (the "**NFP Act**" or the "**New Act**") cannot rely on self-policing by stakeholders to nearly the same extent that the principle of self-enforcement imbues the OBCA/CBCA.

To illustrate the extent to which the place of members in NFP corporations radically differs from the central place of shareholders in business corporations, the JWG considered the possibility that the NFP Act permit corporations wishing to do so to dispense with members entirely. Corporations without members are prevalent in special act non-share capital corporations and are expressly permitted under the 2006 Exposure Draft of the American Bar Association's *Proposed Model Nonprofit Corporations Act, Third Edition* (the "**Draft Model Act**").[6] However, on balance, it was thought that the same end result could be achieved by permitting an NFP corporation to have its members consist exclusively of directors. That is, the directors and members could be identical sets of individuals. See Part III.2 below for a more detailed discussion of self-perpetuating boards.

It follows that, since the place and role of members in an NFP corporation may vary widely from one NFP corporation to the next, the New Act should accommodate the considerable flexibility that NFP corporations and their members may need to organize and govern themselves optimally. Thus, in contrast to the largely mandatory approach to shareholder rights and remedies under the OBCA/CBCA, NFP corporations should enjoy flexibility. With respect to members, the New Act should relax mandatory rules in favour of optional provisions, whether opt-in or default with opt-out.

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[3] R.S.O. 1990, c. B.16 (the "**OBCA**").
[4] R.S.C. 1985, c. C-44 (the "**CBCA**").
[5] See *infra* footnote 24 for a definition of "true membership corporation".
[6] American Bar Association, Section on Business Law, Committee on Nonprofit Corporations, Task Force to Revise the Model Nonprofit Corporations Act.

1. Membership Lists

What information should be contained in membership lists and what should the requirement be for obtaining such a list?

Question (i): Who should be given access to membership lists?

Option A: Allow any person to request a membership list, providing said person uses the list for purposes in connection with the corporation (status quo).

Option B: Restrict access to membership lists. As per the Saskatchewan Act, access could be restricted to members, or any person where the corporation is a charitable corporation (list would still need to be used for purposes in connection with the corporation).

The JWG is concerned that unlimited access to membership lists may become problematic. The circumstances in which membership lists are needed are much more limited in the case of NFP corporations than is the case for shareholder lists under business corporations statutes such as the OBCA/CBCA.[7] In both types of corporations, access to membership lists may be required as a prelude to a contested annual meeting to elect or unseat a board. However, unlike business corporations that may be subject to a take-over bid, NFP corporations are not subject to a change of control transaction as such (since the voting rule is usually one member, one vote in contrast to the one share, one vote rule generally applicable to business corporations). In addition, there is some concern about membership privacy and the possible illegitimate use of membership lists.[8]

Accordingly, the JWG favours a modified version of Option B. The New Act should restrict access to membership lists along the lines of the *Non-profit Corporations Act, 1995* of Saskatchewan [9] but, for purposes of this rule, should not make a distinction between charitable corporations and non-charitable corporations (which is a distinction that the Saskatchewan Act makes for this and certain other rules).

Thus, under the NFP Act, the corporation would prepare and maintain a register of members entitled to vote. On payment of a reasonable fee and on sending the corporation the required affidavit, a member (but only a member) may obtain a basic list of members containing the names and the addresses and/or e-mail addresses of each member.

In general, holders of debt obligations should be required to negotiate all rights (including access to membership lists) in the trust indenture or other agreements entered into between the holders

[7] OBCA, s. 146; CBCA, s. 21.
[8] Note that this concern is not that providing membership lists under the NFP Act would contravene the *Personal Information Protection and Electronic Documents Act,* S.C. 2000, c.5 ("**PIPEDA**"). Providing a list of members in accordance with the New Act would arguably fit within the permitted collection of personal information under s. 7(1)(e)(ii) and permitted disclosure thereof under s. 7(3)(i).
[9] S.S. 1995, c. N-4.2 (the "**Saskatchewan Act**").

of debt obligations and the NFP corporation. Thus, holders of debt obligations should not have a statutory right to obtain membership lists.[10]

Question (ii): Should there be a requirement for an affidavit or statutory declaration to be signed in order to obtain/examine the list of members or should lists be provided upon request?

Option A: Require an affidavit to be signed (status quo).

Option B: No affidavit required, but restrictions for use of membership lists set out in the Act.

The JWG favours Option A, the requirement that an affidavit be provided. The list should only be provided in connection with an effort to influence the voting by members of the corporation or "any other matter relating to the affairs of the corporation".[11] Indeed, at least one member of the JWG believes that a permitted purpose for the list should be narrowly defined and that this general catch-all purpose should be removed.

If a person contravenes the permitted uses of the list, he or she should be liable on conviction of a general offence provision, similar to s. 258 of the OBCA.

Question (iii): Should a right of appeal to the court be provided for cases where access to a membership list is denied?

Option A: Include a right of appeal to the court in the Act for cases where access to a membership list is denied.

Option B: Do not provide a right of appeal.

The JWG does not think that a specific right of appeal needs to be included in the New Act. Rather, it could be included (by explicit reference, if need be) in a general compliance provision along the lines of s. 253(1) of the OBCA. See Part I.6(a) below for further discussion on compliance orders.

In contrast to the OBCA, it would be helpful (especially to lay users) and would enhance transparency to include all membership remedies in one place under the NFP Act (and to codify those common law remedies that have been codified for business corporations under the OBCA).

Question (iv): What information should be included in the membership list?

Option A: Include names of members only.

Option B: Include names of members plus additional contact information, such as e-mail or mailing addresses.

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[10] Differing in this respect from the rights of creditors under OBCA, s. 146(1).
[11] See OBCA, ss. 146(8)(c) and 146(6).

Option C: Allow corporation to determine what information to include in membership lists.

The JWG favours a modified version of Option B. Option A is ineffectual because the recipient does not have enough information to contact any members. The main use of a membership list is to influence voting, and those in control of the corporation will be reluctant to cooperate in making information available on a timely basis to a dissident group. For much the same reason, Option C is likewise problematic.

Some members of the JWG believe, however, that a member should be able to specify to the corporation that the corporation only use, or provide, a physical address or an email address but not both. If, for example, a member only wants communications to be received at a particular email address and not by physical mail, that specification should be possible and honoured by the corporation and any recipient of the membership list.

While this approach would differ from s. 146 of the OBCA, in reality, most shareholders of offering corporations under the OBCA can and do hold their securities through an intermediary. Thus, providing a shareholder list under s. 146 does not yield the name or address of an individual shareholder (unless that shareholder is registered as such in the securities register of the corporation) – thereby permitting a degree of anonymity not available to members of NFP corporations.

Some members of the JWG also think that, instead of providing a membership list, a corporation should have the option to circulate a dissident's information circular or proposal directly to members of the corporation upon payment of the requisite costs. One difficulty with this approach is that it would leave the incumbent board in control of the process, which might serve to undermine or defeat the dissident group seeking to unseat the board. Also, payment of the costs may become a barrier. The incumbent management, who cannot be expected to be neutral in these circumstances, may demand payment of an exorbitant security deposit to deter dissidents.[12] Until it has the membership list, the dissident group may not know whether it is even feasible to proceed with its planned solicitation or other corporate action.

2. Transferability of Membership Interest

Should memberships be transferable? Should the answer vary based on the type of not-for-profit corporation (e.g. charitable, religious, etc.)?

Option A: Membership should not be transferable, unless otherwise stated in the letters patent (status quo).

Option B: Memberships should be transferable without limitation (so long as the basic membership criteria are met).

[12] Note, however, that the regulations to the New Act could limit the type and regulate the amount of expenses that could reasonably be demanded of dissidents. Still, the ability of the incumbent board or management to control the process and determine, at first instance, the amount of a security deposit may have a chilling effect on dissidents.

The JWG favours a modified version of Option A. Memberships should not be transferable unless otherwise stated in the articles. Rights contained in the articles are more entrenched than rights contained in the by-laws, and therefore such a fundamental right (like a right to transfer a membership) should be contained in the articles.[13]

Also, the JWG does not think that it is necessary to distinguish between classes of NFP corporations for this purpose. Thus, it is not necessary to make non-transferability mandatory in the case of religious or other charitable corporations. The opt-in provision will be self-policing. Golf clubs and other types of true membership corporations are free to include transferability provisions in their articles. Pure NFP corporations[14] will generally elect not to include transfer rights that are inappropriate.

3. Termination of Membership and Disciplinary Measures

Should members be entitled to certain guaranteed rights upon termination which will be explicitly set out in the reformed Act? If so, what should those rights be?

Option A: Rights should not be guaranteed in the reformed Act but rather left for designation in the by-laws (status quo).

Option B: Rights should be guaranteed in the reformed Act.

The JWG favours a modified version of Option B. More specifically, the JWG finds attractive the provisions of the California *Corporations Code* which provide that any suspension or termination of a membership or membership rights must be made in good faith and in a fair and reasonable manner. A fair and reasonable manner includes setting out the procedure in the corporation's articles or by-laws, giving a member prior notice of suspension/termination and the reasons for suspension/termination and allowing a member to be heard orally or in writing before the effective date of the suspension or termination. The JWG would specifically add that an oral hearing would not be mandatory under the statutory regime.

A corporation would be free to build upon these basic or minimum membership rights and to offer, for example, a right to an oral hearing. However, entrenching an oral hearing as part of every NFP corporation may not be cost-beneficial to all of these corporations.

Although termination or suspension of membership rights may not have the same economic consequences as the squeeze-out of shareholders under the OBCA/CBCA, the termination or suspension of membership rights entails significant reputational damage. It is, therefore, important to offer some protection against unwarranted reputational damage and enshrine some

[13] There is greater entrenchment of rights contained in articles than in by-laws because articles can generally be amended only by special resolution (requiring the affirmative vote of not less than 2/3rds of members voting thereon) whereas by-laws can generally be amended by the directors (subject to confirmation by members) as under the OBCA model or by simple majority vote of the directors and members as under the *Corporations Act*, R.S.O. 1990, c. C.38 (the "**OCA**").
[14] Defined in the First Submission as: "[a] nonshare corporation that cannot under any circumstances distribute profits or surplus assets to members".

minimal fairness standards within the New Act, leaving it to the individual corporation to decide whether and to what extent to expand these minimum rights as it deems appropriate.

At least one member of the JWG also thought that it would be useful if the New Act were to provide an alternative to judicial review of NFP corporate decisions affecting members' basic rights. Judicial proceedings are prohibitively expensive for many NFP corporations.

One alternative to judicial proceedings would be an expanded role for the Director appointed under the NFP Act. However, this was considered unlikely. Also, it was thought that an expanded role for the NFP Director would make the New Act more of a regulatory statue than an enabling statute, undermining one of the fundamental principles that should infuse the New Act.

Arbitration is another dispute resolution mechanism that might be adopted by an NFP corporation in its by-laws so as to obviate the need for court proceedings and thereby, one hopes, reduce the cost of resolving membership disputes. Statutory recognition of arbitration as an option may add value in the New Act.

Finally, unlike the Saskatchewan Act, the NFP Act should not contain a statutory right to appeal a disciplinary or expulsion decision unless the by-laws so provide (except on the limited grounds of non-compliance with the standards of procedural fairness enshrined in the New Act or embellished in the by-laws).[15] Likewise, the decision of the board or the discipline panel should be final and binding, and there should be no recourse to the membership unless, again, the by-laws otherwise provide.

4. Quorum at Members' Meetings

Should the reformed Act contain explicit rules on quorum for member meetings? If so, what should they be?

Option A: No quorum rules in the reformed Act – leave it up to the by-laws (status quo).

Option B: Include default quorum rules in the reformed Act that apply only when the by-laws are silent.

Option C: Include quorum rules in the reformed Act that apply in all cases (cannot be overridden by the by-laws).

The JWG favours Option B. The difficulty with Option A is that it leaves a vacuum if the by-laws fail to provide for a quorum requirement. The difficulty with Option C is that it may be impossible to find a quorum rule that can apply in all cases but that does not produce a significant number of frustrated membership meetings. Since the strength of the bond between an NFP corporation and its membership can vary widely, quorum rules have to be tailored to the needs of the specific corporation and its membership. Thus, Option B is best.

[15] See the further discussion on the compliance remedy at Part I.6(a).

Either the Saskatchewan Act or the *Canada Not-for-profit Corporations Act* ("**Bill C-21**")[16] would provide a useful model for the New Act. Thus, subject to any overriding provisions of the by-laws:

(a) a quorum would exist where a majority of the members entitled to vote are present or represented by proxy (where a corporation opts-in to allowing proxies);[17]

(b) if a quorum is present at the opening of the meeting, the meeting can proceed even if a quorum is not present throughout the meeting (so as to prevent members of a dissident group from walking out part way through a meeting that is not going in the direction they favour and then arguing that the meeting is no longer valid);

(c) where a quorum is not present within a reasonable time after the opening of the meeting, no business can be transacted and the meeting may be adjourned by those members present to another time and place (with, in all cases, appropriate notice to the members) at which those members present will constitute a quorum; and

(d) where a corporation has only one member or only one member of any class of voting members, that member present in person or by proxy constitutes the meeting.

5. Members' Voting Agreements

Should the reformed Act allow members to enter into voting/pooling agreements?

Option A: No reference to voting/pooling agreements in reformed Act (status quo).

Option B: Allow voting/pooling agreements.

The JWG does not see the need to explicitly provide for voting or pooling agreements in the New Act and, therefore, favours Option A. Not much turns on whether the New Act includes an explicit provision or omits it. Even in the absence of an express provision, it should be possible for one or more members to agree on how they will vote their interests in the corporation.

We observe that, in contrast to the Saskatchewan Act and Bill C-21, the Consultation Paper does not propose a unanimous member agreement ("**UMA**") regime. Adopting a UMA regime may go too far toward elevating members to the level of shareholders under business corporation legislation – giving members the power at any time to appropriate to themselves all board powers, duties and liabilities.

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[16] Bill C-21 died on the Order Paper on November 29, 2005 when the 38th Parliament was dissolved for the January 2006 Canadian general federal election. Bill C-21 represented the latest in a long series of federal initiatives to replace Parts II and III of the *Canada Corporations Act*, R.S.C. 1970, c. C-32 (the "**CCA**"), which for the time being continues to govern most federal nonshare corporations.

[17] See Part I.5A for a further discussion of proxies.

5A. Proxies

Although not discussed in this Consultation Paper or its predecessors (collectively, the "**Consultation Papers**"), the New Act should include provisions dealing with proxy voting. In this regard, the JWG favours adoption of the rule similar to the CCA with respect to voting by proxy.[18] Voting by proxy would only be permitted to the extent that the by-laws expressly permit it.[19] Thus, voting by proxy would not be mandatory and would only be provided on an opt-in basis.

5B. Meetings of Members

(i) Member Requisitions

Although not discussed in the Consultation Papers, the New Act should allow members to requisition meetings of members. To safeguard against possible abuse by unrepresentative minorities, the JWG favours retention of the requirement (currently found in s. 295(1) of the OCA[20]) that a requisitioned meeting requires not less than 10% of the members entitled to vote (rather than the 5% threshold found in s. 105(1) of the OBCA). While members need a way to requisition a meeting to, for example, replace some or all of the board members, a threshold that is too low invites undue harassment of the incumbent board. The 10% threshold is the existing standard, and we see no compelling reason to deviate from it.

(ii) Court-Ordered Meetings

While also not discussed in the Consultation Papers, the New Act should allow members and directors to apply for a court-ordered meeting in circumstances where it is impracticable to call or conduct the meeting in accordance with the Act or the corporation's by-laws. Currently, provision for court-ordered meetings is found at s. 297 of the OCA and s. 106 of the OBCA. Since the court must approve the order, no minimum threshold level of support is appropriate.

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[18] CCA, *supra* footnote 16, s. 157(1) and s. 108.2(1).
[19] We expect that the New Act will include a provision modeled on OBCA, s. 5(3) which allows the articles to include any provision permitted by law to be included in the by-laws (allowing corporations to entrench by-law provisions).
[20] *Supra* footnote 13.

5C. Member Proposals

Although not discussed in the Consultation Papers, the New Act should allow members to submit written proposals to the corporation to be included in notice of the next ensuing annual meeting of members (with appropriate safeguards modelled on s. 295 of the OCA). Again, to safeguard against use of proposals by unrepresentative members and to reduce cost to the corporation, the existing threshold of at least 5% support from voting members set out in s. 296 of the OCA should be retained in the New Act.

6. Member Remedies

(a) Compliance Orders

Should the availability of compliance orders be extended to apply in cases of non-compliance with the corporation's articles and by-laws and who should qualify to apply for such an order?

Question (i): Should the criteria for obtaining a compliance order be broadened to allow complainants to seek compliance with duties in addition to those set out in the reformed Act, such as duties imposed by the articles and by-laws of the corporation?

Option A: Allow complainants to obtain a compliance order only in cases where a corporation fails to comply with the reformed Act (status quo).

Option B: Extend the availability of compliance orders to cases where a corporation fails to comply with duties in addition to those set out in the CA, such as those imposed by the articles or by-laws of the corporation.

The JWG favours a modified version of Option B. Compliance orders should be extended to ensure compliance by the corporation, and its directors and officers, with the duties set out (a) in the New Act (and the regulations thereunder) as well as (b) in the articles and by-laws of the corporation. This is consistent with the OBCA, the Saskatchewan Act and Bill C-21, except that compliance with a UMA would only apply if, indeed, the New Act contains a UMA regime similar to that applicable under the Saskatchewan Act or contemplated under Bill C-21.[21]

Question (ii): Who should qualify as a complainant (that is, entitled to apply to court for a compliance order)? Members and creditors only, or should other complainants be allowed to bring an action as is the case in business corporations statutes such as the OBCA and other NFP corporation statutes such as the Saskatchewan Act and Bill C-21?

Option A: Restrict availability of compliance order to members and creditors (status quo).

Option B: In addition to being available to members and creditors, make compliance order available to any other complainants at the discretion of the court.

[21] But not recommended at Part I.5 of this Submission.

The JWG favours a modified version of Option B. Creditors should have no *per se* rights to invoke remedies under the new NFP Act. Rather, creditors should be required to negotiate with the NFP corporation any rights that they want to have. This would include the rights of holders of debt obligations of an NFP corporation.

Thus, only past and present (i) members, (ii) directors and (iii) officers should have a *per se* right to seek a compliance order. As well, the court should retain the power to extend the compliance order to any other person who, in the discretion of the court, is a proper person to seek the compliance order.[22]

(b) Oppression Remedy

Questions (i) and (ii): Should the oppression remedy be included in the reformed Act and, if so, should religious corporations be excluded?

Option A: Do not include the oppression remedy (status quo).

Option B: Provide the oppression remedy to all not-for-profit corporations, including religious organizations.

Option C: Exclude religious corporations from the oppression remedy.

With respect to the extension of the oppression remedy to cover OCA corporations, there are at least two schools of thought within the JWG: (a) proponents, those who favour extending the oppression remedy to members of NFP corporations; and (b) opponents, those who recommend against such an extension.

Opponents of extending the oppression remedy to NFP corporations see an important distinction between "pure NFP corporations"[23] and "true membership corporations" (such as golf, tennis and curling clubs in which the members may have a significant financial interest in the residual assets of the corporation on its liquidation).[24]

For pure NFP corporations, the oppression remedy is unwarranted and possibly counter-productive. It is misplaced because, by its nature, a pure NFP corporation (unlike a business corporation or a true membership corporation) is not about the individual rights of members but about the corporation's larger charitable or public-benefit purposes or *raison d'être*.

There may be disputes about how the corporation discharges its purposes. However, the way to resolve this type of dispute is to rely on majority rule. As long as members can call a meeting to oust the current board, there should be no need for an oppression action.

[22] See Part I.6(c) for a discussion of judicial extension of the oppression remedy and derivative action to creditors.
[23] Defined *supra* footnote 14.
[24] Defined in the First Submission as: "[a] subset of mutual benefit corporation. A type of corporation that is permitted to distribute surplus assets to its members on liquidation/dissolution. Examples include golf, tennis and curling clubs." The First Submission further defined a "mutual benefit corporation" as: "[a] corporation primarily intended to promote the interests of its members. Subject only to restrictions against distributing profits to members before liquidation/dissolution.".

In a pure NFP corporation, the members have no residual interest in the profits or net assets of the corporation. Thus, the oppression remedy (which is no doubt useful as a protection for minority shareholders whose economic interests are adversely affected by a control group) does not have the same rationale for members of a pure NFP corporation. Opponents also see several disadvantages to extending the oppression remedy to pure NFP corporations, including: expense to the NFP corporations and their board members in defending notoriously expensive litigation; and the pall that this would create for attracting and retaining voluntary board members.

Since, according to its opponents, the oppression remedy is simply ill-suited to pure NFP corporations, the remedy should not even be made available to NFP corporations on an opt-in basis. Allowing incorporators to opt-in to the remedy would inevitably lead to confusion and mistakes. Given the significant proportion of NFP corporations that apply for incorporation in Ontario without apparent legal representation, the JWG anticipates that many NFP corporations will not receive proper legal advice on the pros and cons of opting-in to the remedy.

In these respects, opponents of adopting the oppression remedy part company with both the Saskatchewan Act and Bill C-21, which extended or, in the case of Bill C-21, would have extended the oppression remedy to NFP corporations.

An entirely different analysis applies to true membership corporations (as described above) and OCA share capital corporations. Here, the membership could well have a meaningful financial interest in the residual assets of the corporation and their economic interests may be adversely affected by those in control.[25] The rationale for the self-enforcing oppression remedy under the OBCA fits these types of corporations, lending further support for dealing with pure NFP corporations under the New Act while making separate provision elsewhere for true membership corporations and OCA share capital corporations.

However, the JWG favours retaining a court-ordered winding-up remedy in the New Act such as s. 243 of the OCA. Even though a Draconian remedy, a just and equitable winding-up order under s. 243(d) is needed in extreme cases such as deadlock, fraud, a justifiable lack of confidence in management or a loss of substratum.[26] It has been used in several Ontario NFP cases.[27]

Proponents of an oppression remedy for NFP corporations favour expanding the court-ordered winding-up provision as follows:

(a) add as additional grounds for a winding-up any acts, omissions or conduct that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any

[25] See Terrance S. Carter and Theresa L.A. Man, "Share Capital Social Clubs as NPOs: Issues to Consider" (OBA, 2004), available at: http://www.carters.ca/pub/article/charity/2004/tlmtsc1027.pdf.
[26] At common law, a loss of substratum occurs where there is no longer any reasonable probability of carrying out the business or activity for which the corporation was formed. See *Bleriot Manufacturing Aircraft Co.* (1916), 32 T.C.R. 253 (Ch. Div.). Examples could include failure to obtain an essential licence, patent, contract or grant or frustration of the corporation's stated objects.
[27] See, for example, *Kay v. Nipissing Twin Lakes Rod & Gun Club* (1993), 7 B.L.R. (2d) 225 (Ont. Ct. (Gen. Div.)) and *Warriors of the Cross Asian Church v. Masih* (2007), 87 O.R. (3d) 169 (S.C.J.).

member, director or officer (similar to the expanded grounds in OBCA, s. 207(1)(b)); and

(b) expand the court's ability to grant alternative orders (similar to the court's power under OBCA, s. 207(2) to make the expansive orders contemplated at OBCA, s. 248(3)).

These expansions would enable the court to make a wide array of orders that are less Draconian than liquidation. However, it would confine the applicants to members rather than to holders of debt obligations and other complainants who are held to be proper persons to apply.[28] It would also allow all remedial orders to be located in one place within the New Act. It would spare the parties from litigating whether the oppression remedy applies to NFP corporations even though the New Act may be silent. Even so, access to the oppression remedy and the range of remedial orders would still be wide-open, thereby not allaying the concerns that its opponents have.

Question (iii): Who should qualify to bring forward the action? Members only, or should other complainants, such as former members, directors and former directors, and the government, etc. be allowed to bring the action?

Option A: Make the oppression remedy available to members only.

Option B: Make the oppression remedy available to other complainants (in addition to members), such as former members, directors and former directors, the government, or any other person at the discretion of the court, etc.

Defining a "complainant" for purposes of the oppression remedy may be moot if the arguments of opponents to bringing that remedy to the New Act prevail. See the response to Q 6.(b)(i) and (ii) above. If the oppression order is made available as an alternative remedy in a court-ordered winding-up, then permitted applicants would be co-extensive with permitted applicants for a winding-up.

In that case, we favour limiting court-ordered winding-up so that it is only available on application by a member (as is currently the case under s. 244(1) of the OCA). Creditors would continue to have the power to petition insolvent corporations into bankruptcy under the *Bankruptcy and Insolvency Act*.[29]

(c) Derivative Action

Questions (i) and (ii): Should the derivative action be included in the reformed Act and, if so, should religious corporations be excluded?

Option A: Do not include a derivative action (status quo).

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[28] Note that, unlike under s. 208(1) of the OBCA, creditors with a claim of at least $2,500 should not have the right to apply for a winding-up. Further, we recommend that the OBCA be conformed by amending s. 208(1) so that creditors are no longer qualified to apply for the liquidation of a solvent OBCA corporation.
[29] R.S.C. 1985, c. B-3.

Option B: Provide for a derivative action for all not-for-profit corporations, including religious organizations.

Option C: Exclude religious corporations from the derivative action.

The JWG recommends a modified version of Option B. A statutory derivative action should be extended to all NFP corporations. Unlike the oppression action (which is intended to redress individual members rights), a derivative action is intended to facilitate the enforcement of rights and remedies belonging to the corporation itself (or, less commonly, to facilitate the defence of claims brought against the corporation). It is particularly useful where the wrong-doers are in control of the corporation's board.

A useful model for a derivative action may be found in ss. 245 to 247 of the OBCA. In particular, the leave requirement is a necessary and useful safeguard against vexatious or unmeritorious claims. The applicant must give the board advance notice of the leave application, be acting in good faith and the action must *prima facie* appear to be in the best interests of the corporation. We would add to that an express exclusion such that the court cannot be called upon to make a determination of religious issues or tenets of faith. Religious corporations as such would not be excluded. For example, in appropriate cases, this approach may enable the court to approve a derivative action to recover church property while avoiding adjudication with respect to religious issues or practices.

In the absence of a statutory derivative action, the common law continues to apply to derivative actions involving OCA corporations.[30] The derivative action at common law was found seriously wanting.[31] For example, even the possibility of member ratification of the impugned act or transaction was held to be enough to preclude a member from bringing an action in the name and on behalf of the wronged corporation. In some cases, a majority could vote to ratify the impugned transaction. Hence, when the OBCA went into effect in 1971, it included a statutory derivative action regime.[32] It should now be extended to NFP corporations, implicitly supplanting the remedy at common law.[33]

Question (iii): Who should qualify to bring forward the action? Members only, or should other complainants, such as former members, directors and former directors, and the government, etc. be allowed to bring the action?

Option A: Make the derivative action available to members only.

Option B: Make the derivative action available to other complainants (in addition to members), such as former members, directors and former directors, the government, or any other person at the discretion of the court, etc.

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[30] See, for example, the *locus classicus, Foss v. Harbottle* (1843), 67 E.R. 189, 2 Hare 461 (Eng. V.C.).
[31] See the critique contained in R.W. Dickerson, L. Getz and J.L. Howard, *Proposals for a New Business Corporations Law for Canada: Commentary and Draft Act,* vol. 1 (Ottawa: Information Canada, 1971).
[32] Now OBCA, ss. 246 and 247.
[33] See *Farnham v. Fingold,* [1973] 2 O.R. 132, 33 D.L.R. (3d) 156 (C.A.), holding that the derivative action in the then new OBCA displaced any derivative or representative action available at common law.

The JWG recommends a modified version of Option B. As in the case of the compliance order, the derivative action should be available to complainants, consisting of past and present members, directors and officers and any other person who, in the discretion of the court, is a proper person to apply for leave to bring a derivative action. We recognize that, in some cases, courts under the OBCA/CBCA oppression remedy[34] and derivative action[35] have declared that creditors are proper persons to seek a derivative action - particularly in cases where the control group has engaged in asset-stripping at the expense of creditors (something that is less likely to occur with a pure NFP corporation).

Rather than specifically include as *per se* "complainants" holders of debt obligations, the Office of the Public Guardian and Trustee ("**PGT**") or the Director appointed under the NFP Act, we prefer to leave these possibilities within the discretion of the court – especially bearing in mind that the court also has overall discretion to grant leave to bring the derivative action.

(d) Dissent and Appraisal

(i) Should the reformed Act include the right to dissent and appraisal?

(ii) Should the right to dissent and appraisal be limited to certain types of not-for-profit corporations, such as private membership corporations?

Option A: Do not include the dissent and appraisal remedy in the reformed Act (status quo).

Option B: Provide for dissent and appraisal in the reformed Act.

Option C: Limit the right to dissent and appraisal remedy to certain types of corporations, such as private membership corporations where a membership interest may have significant value.

The JWG recommends Option A. The dissent and appraisal remedy is suited to situations where the dissident has a significant financial interest in the corporation and needs a method of exiting his or her investment rather than enduring a fundamental change that the corporation is about to undertake (such as an amalgamation or sale of all or substantially all of its property). The dissent and appraisal remedy is ill-suited to pure NFP corporations, where, by definition, there is no meaningful financial interest in the profits or net assets of the corporation. The fundamental change should not adversely diminish the member's financial interest in the corporation since, by definition, it is nil or nominal. Among other things, the dissent and appraisal remedy entails a valuation of the minority interest. In this respect, the JWG parts company with the Saskatchewan Act and Bill C-21.

However, the dissent and appraisal remedy is appropriate for true membership corporations (as described above).

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[34] See, for example, *Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc*. (1998), 40 O.R. (3d) 563, 162 D.L.R. (4th) 367 (C.A.) and *Downtown Eatery (1993) Ltd. v. Ontario* (2001), 200 D.L.R. (4th) 289 (C.A.).

[35] See, for example, *A. E. Realisations (1985) Ltd. v. Time Air Inc.,* [1995] 3 W.W. R. 527, 17 B.L.R. (2d) 203 (Sask. Q.B.); affirmed [1995] 6 W.W.R. 423 (Sask. C.A.).

CORPORATE FINANCE

1. Financial Review in lieu of an Audit

Should the reformed Act allow corporations with certain revenue amounts to opt for a review in lieu of an audit? If so, what would be an appropriate income range for which to permit a review?
Option A: No option for review (i.e. corporations with an annual income of $100,000 or more are required to conduct an audit) (status quo).
Option B: Allow corporations with an annual income of up to a certain maximum amount to undergo a review in lieu of an audit.
There are three levels of financial review for a corporation, which in descending order of rigour and cost are as follows:

(a) audit (the most rigorous level, where the independent auditor expresses an opinion on whether the corporation's financial statements fairly present the financial position of the corporation at the end of a fiscal period and the results of its operations for that period);

(b) review engagement (a less rigorous level than an audit, where the accountant must be satisfied that the financial statements are plausible but does not express an opinion thereon); and

(c) compilation report or notice to reader (where the accountant, if any, assumes no responsibility for the content or accuracy of the financial statements and expressly notifies the reader accordingly in the financial statements and where, typically, there are no notes to the financial statements).

Generally, given the public nature of NFP corporations and the important role of an audit within any corporate governance framework, each NFP corporation should be required to obtain an audit except where the costs of the audit are disproportionate to the likely benefits. Thus, under the New Act, the appropriate default rule is that each corporation must have an audit.

Small NFP corporations should be able to avoid the cost of a full-blown audit and instead rely on something less than an audit (either a review engagement or compilation) for its financial statements but that exemption should be narrow and should defined by gross revenue, not by income or profit.

The JWG favours a modified version of the approach under the Saskatchewan Act as balancing the public interest in obtaining audits of NFP corporation financial statements against the incremental costs of subjecting small NFP corporations to the full audit process. However, there should be no separate distinction made for charitable corporations under the New Act as there is under the Saskatchewan Act.

Thus, under the New Act, members of an NFP corporations whose annual revenues in the previous fiscal year[36] do not exceed $100,000 should have the right to resolve to only have a compilation (not an audit or review) in the ensuing fiscal year provided such waiver is by special resolution (*i.e.* the consent of at least 2/3rds of the members voting thereon rather than 80% membership approval as required under the Saskatchewan Act). To keep the threshold current with price escalation generally and audit costs specifically, the $100,000 threshold should be subject to periodic review and increase in the regulations to the New Act.

Members of an NFP corporation whose annual revenues in the previous fiscal year exceed $100,000 but do not exceed $1,000,000 would be permitted to resolve by special resolution to waive the audit in favour of a review engagement (but not a compilation report). Again, these thresholds should be subject to periodic review and increase in the regulations to the New Act.

The follow table summarizes the proposed audit exemption regime for NFP corporations under the New Act:

PROPOSED AUDIT EXEMPTION REGIME

Annual Gross Revenues (AR)	**Member Approval**	**Options**
AR < $100,000.01	**2/3rds of members (special resolution)**	**Can elect review engagement or compilation; otherwise, audit requirement applies.**
$100,000 < AR < $1,000,000.01	**2/3rds of members (special resolution)**	**Can elect review engagement; otherwise, audit requirement applies.**
$1,000,000 < AR	**N/A**	**Mandatory audit.**

Contrary to the OCA, the thresholds should be determined by gross revenues and not income for the immediately completed fiscal year. The net income of a very large NFP corporation may be modest. Many NFP corporations are intentionally run on a relatively flat or cost-recovery basis so that the use of income as a criterion is inappropriate and may exempt many large NFP corporations that ought, in the public interest, to have an annual audit.

Even where the corporation otherwise qualifies to waive the audit or a review engagement, a member or the Director should have the right to apply to court to require an audit along the lines of the court's power to appoint an auditor under s. 149(8) of the OBCA. The court would have the overriding discretion to appoint an auditor even where the corporation otherwise qualifies for an exemption.

[36] Since an auditor is appointed or waived by the members at an annual meeting, the thresholds should be determined by reference to the previously completed fiscal year rather than the then current year.

The determination of auditor independence under the New Act should take the same approach as the determination of auditor independence under s. 152 of the OBCA.[37] Regulation of who can perform an audit should continue to be exclusively dealt with in the *Public Accounting Act, 2004*.[38]

As under the OBCA, the description of an NFP corporation's financial statements should be set out in the regulations to the New Act, which should also state that the financial statements must be prepared in accordance with the standards, as they exist from time to time, set forth in the Handbook of the Canadian Institute of Chartered Accountants. Currently, these statements consist of a statement of financial position (formerly, a balance sheet), statement of operations (formerly, a statement of profit and loss) and statement of source and application of funds. The regulations should go on to state that financial statements need not be designated by these names. Some NFP corporations may use different names for some statements or may be required to prepare other statements. Furthermore, we understand that the accounting profession is currently reviewing the entire NFP accounting regime and that the names of these financial statements may, as a result, undergo further change.

The JWG is concerned that a near-universal audit requirement and the exemption of directors, officers and employees of NFP corporations from personal liability[39] may combine to produce the unintended consequence of exposing auditors to heightened liability to NFP corporations. The appropriate solution may lie in a broader proportionate liability regime so that auditors (and independent accountants providing review engagements or compilation reports) are not exposed to a liability that is disproportionate to their actual fault.[40]

2. Financial Disclosure

What should the level of access to financial statements be for members?
When should members be provided with the corporation's financial statements?
Option A: Members to be provided with financial statements at the annual meeting (status quo).
Option B: Make financial statements available to members prior to the annual meeting, similar to the Saskatchewan Act. By-laws could require that financial statements be sent to members prior to the annual meeting upon request.
Option C: Allow corporations to decide whether or not to provide members with access to the corporation's financial statements prior to the annual meeting.

The JWG favours a modified version of Option B. Financial reporting is integral to corporate governance and is needed to ensure transparency and accountability. Providing financial statements only at the annual meeting does not give members an adequate opportunity to assess and act on the performance (or non-performance) or integrity of the corporation's board of

[37] Currently, OCA, s. 96(1) contains a truncated version of OBCA, s. 152.
[38] S.O. 2004, c. 8.
[39] As we recommended in our Second Submission.
[40] Also, proportionate liability regimes exist under Part XIX.1 of the CBCA and Part XXIII.1 of the *Securities Act*, R.S.O. 1990, c. S.5, s. 138(6). See The Hon. W.Z. Estey, Q.C. "Proportionate Liability and Canadian Auditors", Brief Prepared for Legal Liability Task Force, Canadian Institute of Chartered Accountants (January 23, 1996).

directors and management.[41] Thus, Option C fails to properly integrate financial reporting into the corporate governance process – particularly when assessing the performance of the board of directors and management at the annual meeting. For much the same reason, Option A is sub-optimal.

As under the OBCA, financial statements should be made available to those members who would like them in advance of the meeting.[42] The amount of advance notice could be set in the by-laws but, like a non-offering corporation under the OBCA, should be available not less than 10 days before the annual meeting.[43] However, since, in reality, many Ontario NFP corporations will be hard-pressed to comply with this standard, the New Act might include a provision stating that proceedings at an annual meeting are not invalidated just because of late delivery of financial statements provided they are delivered either before or at the annual meeting.

Corporations should also have the option to present full or abbreviated financial disclosure to members.

Further, it is not practicable to give every member of every NFP corporation financial statements.[44] The default rule under the New Act should be modeled on the recent amendment to s. 154(3) of the OBCA. Thus, like an offering corporation, an NFP corporation would only be required to circulate its annual financial statements to members who have informed the corporation that they wish to receive a copy of the statements. The corporation could discharge its obligation to disseminate financial statements either by sending a hard copy or by posting the financial statements on the corporation's website (perhaps on a page accessed through a membership identification or passcode). In these ways, an appropriate balance can be struck between making timely financial information available to members as a governance tool while, at the same time, reducing the unnecessary and unwanted burden on NFP corporations.

3. Borrowing and Debt Issuance

Should directors have the power to borrow and issue debt without a specific by-law being passed, similar to the Saskatchewan, OBCA and Bill C-21 models?
Option A: By-laws for borrowing/issuing debt must be passed and approved by members (status quo).
Option B: Directors have the right to authorize borrowing/issuing debt subject to the restrictions set out in the corporation's by-laws, similar to the Saskatchewan and OBCA models.
Option C: Directors have unlimited rights to authorize borrowing as an exercise of the natural powers of the corporation.

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[41] Of course, in an egregious case, members are not without remedies such as requisitioning a special meeting to replace the board, bringing a derivative action or seeking a compliance order. However, there are few incentives and several disincentives that effectively deter use of these remedies.
[42] OBCA, s. 154(3), applicable to offering corporations.
[43] OBCA, s. 154(4), applicable to non-offering corporations.
[44] A private charitable foundation with only a handful of members is an example of a situation where it should be practicable to give each member a copy of the financial statements.

The JWG strongly favours Option B. The borrowing regime for NFP corporations should be similar to s. 184(1) and (2) of the OBCA except that, like the CBCA, the introductory language of s. 184(1) should recognize amendments made to the Québec *Special Corporate Powers Act*[45] in 1992. The introductory language should not include the language of s. 184(1) to the effect that articles "are deemed to state" certain borrowing powers. Thus, the opening language should read:

> Unless the articles or by-laws otherwise provide, the directors of a corporation may, without authorization of the members, …

The power to borrow would, therefore, be the default rule applicable to each NFP corporation. Directors of a NFP corporation would have the power to borrow and grant security on behalf of the corporation, but the corporation would be entitled to vary the default rule in its articles or by-laws.[46]

[45] R.S.Q. 1977, c.P-16, as amended by S.Q. 1992, c. 48, ss. 643-44. A companion amendment should also be made to s. 184(1) of the OBCA.
[46] OBCA, s. 17(1) and ss. 184(1) and (2).

OTHER

1. By-laws

Should a system of standard, default by-laws be adopted in the reformed Act?

Option A: No standard default by-laws in the reformed Act (status quo).

Option B: Adopt standard default by-laws.

The JWG favours Option A. Default by-laws must be maintained and up-dated. If a set of default by-laws were included in a table to the New Act (similar to the Table A articles of associations in the English *Companies Act* or the Nova Scotia *Companies Act*[47]), maintenance or updates would require constant changes to the regulations. The JWG, therefore, favours instead, having the MGCS prepare sets of by-laws to be included in an updated version of its Not-For-Profit Incorporation Handbook and also posted on its website. Incorporators could easily adopt a set of model by-laws by selecting the version appropriate to the nature of the intended corporation. For example, a charity will have a different set of requirements than a day-care.

2. Self-Perpetuating Board

Should the reformed Act prevent the possibility of self-perpetuating boards?

(i) Should the reformed Act impose a requirement that all not-for-profit corporations have a minimum number of members who are not directors (that is, prevent the possibility of a self-perpetuating board)?

(ii) If so, should it only apply in the case of public benefit corporations?

Option A: Allow for a self-perpetuating board.

Option B: Eliminate the possibility of a self-perpetuating board for all types of not-for-profits (by requiring that a minimum number of voting members cannot also be directors).

Option C: Eliminate the possibility of a self-perpetuating board for public benefit corporations only, with exceptions where appropriate (by requiring that a minimum number of members cannot also be directors).

The JWG strongly favours Option A: permit a self-perpetuating board. Board members should not be required to be members, an anachronism that ceased to apply to business corporations with the advent of the OBCA in 1971. Likewise, there should be no requirement for a corporation to have some members who are not directors. There would be no loss of transparency, accountability or protection against harm resulting from such flexibility. Having one member who is not a director but who may be outvoted by those members who are directors

[47] R.S.N.S. 1989, c. 81.

is not a mechanism for holding the board accountable any more, for example, than having a dissident director on the board.

Allowing for overlapping members and directors may be appropriate for certain NFP corporations. It would allow all corporations to have a similar structure under the NFP Act (*i.e.* a board of directors, a membership and a default division of powers between the board and the membership) without impeding corporations from achieving the functional equivalent of having no members.

If overlapping members and directors is permitted, then the New Act should explicitly authorize combined meetings or combined resolutions in writing, dispensing with a further unnecessary formality.

CONCLUSION

Finally, we close as we began at the outset in the First Submission. The JWG commends the MGCS for taking on this important, badly overdue area of corporate law reform and urges it to keep up the pace so that Ontarians can look forward to the day when the current antiquated, dysfunctional law is replaced with a modern, well-conceived regime. We congratulate the Ministry and its staff both for preparing stimulating Consultation Papers and engaging in a open dialogue with Ontarians on the shape of the New Act at meetings across the Province. We look forward to the next steps in the creation of the New Act.

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