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September 28, 2007

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 to the Ministry
of Government Services on the May 7, 2007 Phase III
Business Law Modernization Consultation Paper**

On behalf of the Ontario Bar Association ("OBA"), we are pleased to enclose the joint submission of the Joint Working Group of the OBA Corporate Law Subcommittee, Business Law Section and the Charity and Not-for-Profit Law Section on the above Consultation Paper.

As stated in our enclosed submission, we welcome the opportunity for further input on the Consultation Paper and our submission in response to it.

Yours truly,

Wayne D. Gray, Chair, Corporate Law
Subcommittee and Co-Chair, NFP Joint
Working Group

David P. Stevens, Co-Chair, NFP Joint
Working Group

Paul Stoyan, Chair, OBA Business Law
Section

The Voice of the Legal Profession

**Submission of the Ontario Bar Association
to the
Ministry of Government Services**

Phase III Business Law Modernization Consultation Paper

Introduction

What follows is the joint submission of the Corporate Law Subcommittee (“**Subcommittee**”), Business Law Section, Ontario Bar Association (“**OBA**”) and Charity and Not-for-Profit Law Section (the “**Charities Section**”), OBA on the Phase III Business Law Modernization Consultation Paper dated May 7, 2007 (the “**Consultation Paper**”) prepared by the Ministry of Government Services (“**MGS**”), Policy and Consumer Protection Services Division.

Who We Are

The OBA is the voice of over 17,000 Ontario lawyers, law professors and law students and it provides, as part of its public service mandate, non-partisan advice and commentary on statutory law reform – particularly existing and proposed legislation and legislative amendments affecting Ontarians.

The Subcommittee has had a long, proud record of success working closely with MGS, its predecessors and its federal counterpart, the Department of Industry Canada, on various business law reform initiatives, particularly those relating to corporate law. Most recently these successful collaborations have included Phases I and II of Ontario’s 3-phase business law modernization project first announced in the May 11, 2005 Ontario Budget. Phase I consisted of the *Securities Transfer Act, 2006*¹ which went into effect on January 1, 2007. Phase II consisted of the modernization of the *Business Corporations Act*,² the *Personal Property Security Act*³ and the limited liability partnership shield contained in the *Partnerships Act*.⁴ Most of Phase II went into effect on August 1, 2007.⁵

Equally, the Charities Section brings together lawyers who have a particular expertise in the charities and not-for-profit (“**NFP**”) sector. These lawyers represent the widest possible range of charitable and NFP organizations, incorporated and unincorporated, national and local, providing the full spectrum of services to their respective communities. Members of the Charities Section represent organizations and also advise boards, management and membership groups on corporate, tax, fund-raising and other regulatory issues and, therefore, bring a rich diversity of

¹ S.O. 2006, c. 8 (the “**STA**”).

² R.S.O. 1990, c. B.16 (the “**OBCA**”).

³ R.S.O. 1990, c. P.10.

⁴ R.S.O. 1990, c. P.5.

⁵ *Ministry of Government Services Consumer Protection and Services Modernization Act, 2006*, S.O. 2006, c. 34 (“**Bill 152**”).

perspectives to bear on the reform of NFP corporate law. Members of the Charities Section were instrumental in drafting Bill C-21, the *Canada Not-for-profit Corporations Act* (“**Bill C-21**”)⁶ and in preparing the submission of the Canadian Bar Association (the “**CBA**”) on Bill C-21 (the “**CBA C-21 Submission**”).⁷

Collectively, therefore, the joint working group of the Charities Section and the Subcommittee (the “**JWG**”) provides the combined viewpoints of lawyers with extensive experience advising NFP organizations and lawyers with extensive experience in corporate law matters.

Suggested Approach

Before addressing the specific content of the Consultation Paper, the JWG wants to take a moment, first, to applaud the efforts of MGS in tackling this important, badly-needed area of corporate law reform and the efforts of its staff in preparing an excellent initial Consultation Paper.

Second, the JWG thought it worthwhile to suggest an alternative approach to modernization of the law governing nonshare corporations.

The implicit direction of the initial Consultation Paper, and the contemplated consultation papers that will follow it, is that MGS will engage in the widest possible consultation process with a large and diverse stakeholder group and that out of this will emerge a clear vision for a new Act. The JWG has several reservations as to the likely success of this approach. One is that the consultation process is likely to become so wide and the issues so numerous that the process will lack focus or direction. Further, such a consultation process, if it is ever concluded, will take an extraordinary amount of time - given the vast terrain and the diversity of the NFP sector. In any case, the consultation process will result in prolonging the day when Ontarians can finally benefit from badly-needed new legislation.

Ontario should not assume that it must start from scratch in building its new nonshare corporations statute. Rather, it can build on the considerable work and experience close at hand that has preceded this new Ontario initiative.

The JWG thought that the alternative to the widest possible consultation process is to focus on developing a model statute for discussion purposes. The starting point would be either Bill C-21 or the Saskatchewan *Non-profit Corporations Act, 1995* (the “**SK Act**”).⁸ While not serving as the base model statute, additional, useful concepts for the new Act could be drawn from the

⁶ 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.

⁷ See Canadian Bar Association, “Submission on Bill C-21, *Canada Not-for-profit Corporations Act*” (CBA, National Charities and Not-For-Profit Section, CBA: September, 2006).

⁸ S.S. 1995, c. N-4.2.

American Bar Association *Revised Model Nonprofit Corporation Act* (1987) (the “**ABA Model Act**”).⁹ Using a combination of these statutes as models or supplementary sources, the JWG would be prepared to draft, for discussion purposes, an Ontario statute that would serve as the focal point for further consideration. We expect that the vast majority of the issues relating to nonshare corporations law would be uncontentious. Preparation of a draft statute would enable the uncontentious matters to be settled while, at the same time, channelling attention on the handful of contentious or debatable items.

A Brief Lexicon

At the outset, we wish to clarify the use of certain terms used in this submission:

Term	Meaning
charitable corporation	A nonshare corporation that carries out activities that would be considered charitable at common law or for purposes of the <i>Income Tax Act</i> (Canada). ¹⁰ Charitable corporations comprise approximately 1/3 of all corporations formed under the <i>Corporations Act</i> (Ontario) (the “ OCA ”). ¹¹ Charitable corporations are a subset of public benefit corporations.
member corporation	Used here interchangeably with mutual benefit corporation.
mutual benefit corporation	A corporation primarily intended to promote the interests of its members. Subject only to restrictions against distributing profits to members before liquidation/dissolution. May include quasi-economic interests such as would be found in golf, tennis and curling clubs. Found in ABA Model Act and the SK Act.
non-soliciting corporation	A corporation that does not seek to obtain funding from members of the public and does not receive funding from government at any level or another soliciting corporation.
public benefit corporation	Contrasted with mutual benefit corporations. Incorporation as a public benefit corporation is intended as a necessary, but not sufficient, condition to becoming recognized as a charity by the Canada Revenue Agency (“ CRA ”). Cannot distribute profits to members before or on liquidation/dissolution but rather must, on liquidation/dissolution, distribute surplus assets to one or more registered charities or the

⁹ The ABA Model Act is currently under revision.

¹⁰ R.S.C. 1985, c.1 (5th Supplement) (the “*Income Tax Act*”).

¹¹ R.S.O. 1990, c. C.38.

	government. Found in ABA Model Act and the SK Act.
pure NFP corporation	A nonshare corporation that cannot under any circumstances distribute profits or surplus assets to members.
religious corporation	A subset of public benefit corporations. However, subject to certain relaxed rules and protections against intrusive actions by regulators, courts and members. Found in ABA Model Act and, to a much lesser extent, in Bill C-21.
soliciting corporation	A corporation that seeks to obtain funding from members of the public or receives funding from any level of government or any other soliciting corporation.
true membership corporation	A subset of mutual benefit corporations. A type of corporation that is permitted to distribute surplus assets to its members on liquidation/dissolution. Examples include golf, tennis and curling clubs.

Leading Legislative Models

Some quick highlights of each of Bill C-21, the SK Act and the ABA Model Act are outlined below.

Model	Comments
Bill C-21	<p>Most complete and recent effort at a legislative model in Canada.</p> <p>A federal statute that is likely to be influential on provincial legislative developments in the area.</p> <p>Would have to be customized to fit provincial level of legislative jurisdiction.</p> <p>Modelled on the <i>Canada Business Corporations Act</i> (the “CBCA”),¹² which in turn has served as a model for other Ontario corporate legislation such as the OBCA¹³ and the <i>Credit Unions and Caisses Populaires Act, 1994</i> (Ontario).¹⁴</p> <p>Does not adopt a classification system. In particular, does not differentiate between (1) charitable or public benefit corporations, and (2) member or mutual benefit corporations.</p>

¹² R.S.C. 1985, c. C-44.

¹³ *Supra*, footnote 2.

¹⁴ S.O. 1994, c. 11.

	<p>Instead differentiates between corporations on the basis of whether the corporation (1) solicits funds from the public or (2) obtains funding from government sources or another soliciting corporation (called in Bill C-21 “soliciting corporations”) or does not seek or obtain funds from such “public sources” (which may for convenience be called “non-soliciting corporations”). The application of certain rules differs depending on whether the corporation is soliciting or non-soliciting. Not much differentiation for religious corporations, which Bill C-21 does not attempt to define.</p> <p>The CBA saw many good features in Bill C-21, including, for example, flexibility in providing notices to members and audit exemptions.¹⁵</p> <p>Criticisms from the CBA and others included: the distinction between soliciting and non-soliciting corporations and the effort to regulate the fund-raising activities of federal corporations; alleged excessive use of mandatory (rather than permissive) rules on all corporations; possible intrusion into the affairs of religious corporations; excessive focus on members rights, powers and remedies, including the dissent and appraisal remedy and the statutory oppression remedy; and perhaps too-close overall adherence to the CBCA as a model.</p>
SK Act	<p>The most modern enactment in Canada at the provincial level. Work to customize CBCA-model nonprofit legislation to provincial legislative jurisdiction has been done.</p> <p>Has been in operation for more than 10 years. Few, if any, difficulties encountered.</p> <p>Does not employ the distinction between soliciting corporations and non-soliciting corporations.</p> <p>Makes a distinction between charitable corporations (like public benefit corporations) and member corporations (like mutual benefit corporations). No separate recognition for religious corporations.</p> <p>Made many significant innovations, including, audit exemptions for small corporations and immunity of directors, officers, employees and agents from liabilities (other than fraud or criminal misconduct so long as, in the case of a director or officer, he or she was acting in good faith).¹⁶</p> <p>Flexibility in providing notices to members – which could be further developed to take into account subsequent technological and communications advances</p>

¹⁵ See CBA C-21 Submission, *supra*, footnote 7.

¹⁶ SK Act, s. 112.1.

	<p>such as the use of electronic mail and Internet websites.</p> <p>Reads like the <i>Business Corporations Act</i> (Saskatchewan) (the “SBCA”)¹⁷ except with the substitution of members for shareholders. Like the OBCA, the SBCA is itself closely modelled on the CBCA.</p>
ABA Model Act ¹⁸	<p>Unlike any other corporate statute in Canada. Uses terminology, concepts and an internal organization that are largely unfamiliar to Canadian lawyers and the lay public, that may entail a steep learning curve and that make it inappropriate as the base model. However, it could be tapped as a rich source of concepts.</p> <p>Now 20 years old and, as is evident by the ongoing efforts at revision, is dated.</p> <p>Reflects significant American scholarship and expertise at that time.</p> <p>Classifies corporations into mutual benefit, public benefit and religious.</p> <p>Provides definitions for public benefit corporations. Religious corporations are a subset of public benefit corporations. Mutual benefit corporations form the residual category.</p> <p>Calls for a large quasi-regulatory and enforcement role for the state attorney general (which has not been the norm in Ontario to date).</p>

We recognize that no matter which model one starts with, substantial customization is required. For example, given the advent of the STA,¹⁹ there is no need to replicate Part 6 (sections 38-104) of Bill C-21 dealing with transfers of debt obligations nor Division VI (ss. 33-68) of the SK Act. Likewise, there would be no need for Part 7 of Bill C-21 or Division VII of the SK Act on trust indentures because Part V of the OBCA applies to all issuers of debt obligations issued under a trust indenture for which a prospectus has been filed under the *Securities Act* (Ontario).²⁰ Nor would there be any need for Part 8 of Bill C-21 or Division VIII of the SK Act on receivers and receiver-managers because these are covered at the provincial level under Rule 41 of the Ontario *Rules of Civil Procedure*.²¹ Nor too would there be any need for Part III of the SK Act (ss. 252-263) on the registration of extra-provincial corporations because of the combined effect of the *Business Names Act* (Ontario)²² and the *Extra-Provincial Corporations Act* (Ontario),²³ governing Canadian domestic and foreign corporations respectively.

¹⁷ R.S.S. 1978, c. B-10.

¹⁸ Currently under revision. See footnote 9.

¹⁹ *Supra*, footnote 1.

²⁰ R.S.O. 1990, c. S.5.

²¹ R.R.O. 1990, Reg. 194.

²² R.S.O. 1990, c. B.17.

²³ R.S.O. 1990, c. E.27.

Having made these general comments, this submission now turns its attention to the specific questions posed in the Consultation Paper, following the numbering sequence set out in the Paper.

1. Incorporation Process

Should Ontario move from a letters patent system to a system of incorporation “as of right”? If so, how should the system of incorporation “as of right” operate? What basic legal requirements would have to be met for an incorporation application to be accepted under the “as of right” system? How should the “as of right” system apply to charitable corporations?

Ontario should adopt an incorporation “as of right” system. Like incorporation “as of right” under the OBCA, incorporation of a nonshare corporation should only be subject to name approval. We note that Bill C-21, the SK Act and the ABA Model Act each provide for incorporation “as of right”.

The new Act should be a facilitative document focused on primarily procedural rather than substantive matters. The new Act should not be primarily regulatory.

Like the OBCA, the new Act should, as discussed further at Part 5 below, abolish the *ultra vires* doctrine as it applies to nonshare corporations. Except to the extent otherwise provided in the articles, a nonshare corporation should have the corporate power and capacity of a natural person. A corporation’s articles could opt to set out limits on the corporation’s permitted activities or powers. However, if a corporation strayed beyond its permitted activities and purposes as stated in its constating document, this should not affect the validity of contracts or transactions involving third parties. Instead, contravention could, for example, give rise to an action by a member to obtain a compliance or restraining order to ensure that the corporation adheres to its stated activities or goals.

The new Act must give incorporators the option to include restrictions on activities or objects in a corporation’s articles. For example, a charitable corporation is required to state its objects in its letters patent or restrict its permitted activities and powers in its articles of incorporation in order to effect its charitable purposes and to obtain recognition as such from CRA.²⁴ Adopting restrictions in its articles is how a charitable corporation is formed under the SK Act, and the CRA has found this to be acceptable.

The incorporation form should direct applicants for incorporation of a charitable or public benefit corporation (many of whom are likely to seek incorporation without the benefit of legal advice or advice from lawyers who specialize in the formation of NFP corporations) to check out

²⁴ Under the *Income Tax Act*, a charity may not only qualify for tax-exempt status on its income but may also qualify to issue receipts that entitle donors to obtain federal and provincial tax credits on their own income tax liabilities.

the website of the Public Guardian and Trustee (the “**PGT**”) to ensure that, in addition to incorporation, the corporation obtains approval for its intended charitable purpose.²⁵

2. Structure of the New Act

Should the new Act follow the structure of the OBCA, the provisions proposed in Bill C-21, the *California Corporations Code* or another structure?

The new Act should not reintegrate NFP corporations with the OBCA – the situation that prevailed in Ontario before 1971. That is, there should continue to be a separate statute, the OBCA, to deal with business corporations.

Ontario should provide for the following statutory regimes, each of which is clearly differentiated on the basis of for whose benefit the profits or gains of the corporation may accrue:

Type of Corporation	Defining Characteristics	Governing Statute
Business corporation	Profits and surplus assets accrue to the benefit of shareholders (who are the residual risk-takers in the enterprise). Current profits paid to shareholders as dividends. Net surplus on liquidation/dissolution paid to shareholders as liquidation distribution.	OBCA (provincial); CBCA (federal).
Cooperative corporation	Members entitled to only a maximum fixed rate of return. Surplus profits and assets accrue in favour of patrons (usually customers or suppliers, depending on whether the corporation is a consumers’ cooperative or a producers’ cooperative).	<i>Co-operative Corporations Act</i> (Ontario) (“ OCCA ”); ²⁶ <i>Canada Cooperatives Act</i> (federal). ²⁷

²⁵ If it is critical for MGS to ensure that the new Act is not at odds with other relevant legal regimes affecting NFP corporations, including, in particular, the federal tax system and the provincial regime regulating the activities of charities. As well, some ready mechanism should be developed so that a newly founded charitable corporation can adopt PGT’s mandatory requirements for charitable corporations.

²⁶ R.S.O. 1990, c. C.35.

²⁷ S.C. 1998, c.1.

	Surplus profits and net assets on liquidation/dissolution paid to patrons as patronage dividends.	
Charitable or public benefit corporation; and certain member or mutual benefit corporations that are willing to restrict the distribution of profits and surplus assets to members on current basis and on liquidation/dissolution.	Members not entitled to either current distribution or distribution of any surplus assets on liquidation/dissolution. On liquidation/dissolution, surplus assets must, in accordance with letters patent (or articles) be paid to organizations carrying on similar activities – <i>cy-prés</i> jurisdiction.	Ontario: currently, Part III and various sections in Part II of the OCA, ²⁸ which, in whole or in part, would be superseded by the new Act. Federal: currently, Parts II and III of the CCA; ²⁹ Bill C-21 would have replaced these Parts of the CCA.

What is still not fully settled is whether the new Act should attempt to treat member corporations that are permitted to distribute surplus assets to their members on a liquidation/dissolution within the same legislative regime governing corporations that cannot make any distributions to members either currently or on liquidation/dissolution. One option is to include these member corporations (examples include golf, tennis and curling clubs, which for convenience may be called “true membership corporations”) in the new Act. Another approach is to not mix these fundamentally different types of corporations within the same statute but to confine the new statute to NFP corporations that cannot distribute profits or surplus assets to members (which for convenience may be called “pure NFP corporations”).³⁰ In this later case, true membership corporations would either be left behind in the OCA or the members of the corporation could choose whether to convert the corporation into a business corporation under the OBCA, a cooperative corporation under the OCCA or a nonshare corporation under the NFP Act.

Fitting both pure NFP corporations and true membership corporations into the same Act would have the advantage of avoiding multiple statutes, achieving legislative economy. Also, some believe that the dichotomy between pure NFP corporations and true membership corporations is difficult to apply to all nonshare corporations and that members ought to have some residual financial interest in the surplus assets of the corporation. On the other hand, others believe that the fundamental differences between pure NFP corporations and true membership corporations

²⁸*Supra*, footnote 11.

²⁹ *Supra*, footnote 6.

³⁰ One advantage of this approach is that it would provide clarity of purpose for, and eliminate confusion within, the new Act and the corporations governed by it.

warrants their treatment in two separate statutes and that this would lead to a clearer separation in the mind of the public.

Professor Henry Hansmann is a strong adherent to the bifurcation of pure NFP corporations and true membership corporations:

In sum, I am suggesting that only three fundamental types of corporation need to be provided for in the general corporation statutes, each of which is characterized by a different relationship between the organization and its patrons. First, for those situations in which simple individual contracts provide an adequate means by which patrons can police the producer's price and performance, there is the business corporation. Second, for situations – such as those involving natural monopoly – in which simple contractual devices are inadequate to protect the interests of patrons, but in which direct patron control over the organization is sufficient for this purpose, there is the cooperative corporation. And third, for situations – such as those characterized by contract failure – in which neither simple contractual devices nor direct patron control provide adequate and workable means by which patrons can police producers, there is the nonprofit corporation.

Each of these corporate types should be covered by a separate statute and designated by a clear label. Because these corporate types represent, in a sense, ascending levels of protection for the patron, efforts to permit the less constrained corporate types to be formed under the more restrictive statutes will only confuse the purpose of these statutes and hamper their ability to function as they should. In particular, any adjustment to a nonprofit statute that permits organizations to be formed under it that are essentially cooperatives undermines the effectiveness of the nonprofit statute, just as adjusting a cooperative statute so that it can also accommodate ordinary joint-stock companies would severely weaken the cooperative statute, and would deprive the term “cooperative” of any coherent meaning.³¹

Clearly, whether the new Act should be confined to pure NFP corporations is a pivotal issue. The JWG would welcome the opportunity for further input on this, and all other threshold issues, before MGS reaches any firm decisions.

Subject to the above unresolved issue, the new Act would apply to all Ontario nonshare corporations formed under the new Act, any special act of the Provincial Legislature or any general act other than the new NFP Act. The new Act should contain all of the corporate law rules that apply to nonshare corporations (except to the extent otherwise provided in the special or other general act).³² In that way, the new Act would become the default statute for Ontario nonshare corporations.

³¹ Henry B. Hansmann “Reforming Nonprofit Corporations Law” (1981), 129 U. Pa. L. R. 497 (“**Hansmann**”) at p. 597. See, also, Professor Hansmann’s earlier work, Henry B. Hansmann “The Role of Nonprofit Enterprise” (1980), 89 Yale L.J. 835.

³² Except that the new Act would not duplicate Part V of the OBCA, which would continue to apply to all issuers of debt obligations (including nonshare corporations) issued under a trust indenture for which a prospectus has been filed, and receipt obtained, pursuant to the *Securities Act* (Ontario), *supra*, footnote 20.

The new Act should follow the same logical structure as depicted in the OBCA, following the life of a corporation: incorporation; finance; membership; members' meetings and proxies; directors and officers; fundamental changes; liquidation and dissolution; and remedies.

3. Definition of a Not-for-profit Corporation

3.1 Not-for-profit Purpose

3.1.1 Classification of Purposes

Should the new Act clarify the permitted purposes of NFP corporations? If so, how? Should the new Act contain a list of permitted purposes of NFP corporations? If so, what should be included in the list of permitted purposes? Should the new Act prohibit certain purposes of NFP corporations? If so, what purposes should NFP corporations be prohibited from undertaking? If a classification system is adopted in the new Act, should permitted purposes of NFP corporations be tied to the definitions of other various classes?

On defining NFP corporations by a purpose test, Professor Hansmann has stated:

Restricting the purposes for which nonprofits can be incorporated serves no obvious need that could not be better served by other means. Moreover, to the extent that the statutory restrictions actually limit the scope of nonprofit activity, they might well cause unnecessary harm. The service sector of our economy is growing rapidly, both in absolute terms and as a fraction of the nation's total economic activity.... A restrictive, and particularly a conservative, approach to nonprofit incorporation might therefore inhibit the development of these services, or push them inappropriately into the proprietary or governmental sectors.

The wiser course would be to permit nonprofit corporations to be formed for the purpose of undertaking any activity whatever (consistent, of course, with the nondistribution constraint and the criminal law).³³

The new Act should not set out a list of permitted purposes. Rather, a nonshare corporation should be permitted to carry out any purpose other than the pursuit of profit for distribution to its members. It might help clarify matters if the new Act referred not to NFP corporations but instead to nonshare corporations since the distinctive characteristic of corporations formed under the new Act is that they would not have shares and, therefore, would not be able to pay dividends or, on liquidation/dissolution, distribute their residual assets to members.³⁴ Avoiding the NFP

³³ Hansmann, *supra*, footnote 30 at pp. 526-7.

³⁴ This formulation assumes that the new Act would cover pure NFP corporations and would attempt to provide for true membership corporations. If true membership corporations are to be included in the new Act, then they would be precluded from making current distributions to members but would not be precluded from distributing residual assets to members on a liquidation/dissolution. In any case, whether the new Act covers public benefit corporations and true membership corporations or only covers public benefit corporations and mutual benefit corporations subject to the same distribution constraint, the Act would provide that public benefit corporations cannot make distributions to members either on a current basis or on liquidation/dissolution.

term would be less confusing to the public if the Act includes corporations that can, in fact, distribute profits or surplus assets to members.³⁵

3.1.2 For-Profit Activities

Should the new Act regulate for-profit or commercial activities undertaken by NFP corporations? Should for-profit or commercial activities be regulated through a non-commercial purpose constraint, the mandatory use of a subsidiary to carry out for-profit activities, a restriction on the size of the for-profit undertaking or by another method? If the for-profit or commercial activities are regulated, should certain NFP corporations be entitled to exemptions where their activities are for the benefit of an entire community (e.g. aboriginal economic development corporations)?

The new Act should not seek to regulate the for-profit or commercial activities undertaken by a nonshare corporation. The new Act is not the place to set out such regulation. As well, it is difficult in practice to make a valid distinction between nonprofit activities and for-profit activities carried out by an NFP corporation that are used to subsidize or fund its nonprofit activities. A museum gift shop may be carried out for profit by an NFP museum. However, the profits serve to subsidize the cost of keeping the museum operational. For these and other reasons, it is difficult to draw a meaningful line between the for-profit and nonprofit activities of NFP corporations.

A fortiori, an NFP should not be required to use a subsidiary to carry on for-profit activities. An NFP corporation should not be required by the corporate statute to carry on part of its activities through a subsidiary.

3.2 Non-Distribution Constraint

Should the current provisions governing the distribution of assets during the life of the corporation be clarified by codifying existing practices? Should the current provisions governing the distribution of assets upon the dissolution of a corporation be clarified by codifying existing practices? Should the new Act model its non-distribution constraint on the SK Act, proposed provisions in Bill C-21, the Ontario Law Reform Commission (“OLRC”) recommendation or another model?

Distribution constraints are the core of what must be required of an NFP corporation.³⁶

A charitable corporation will be required to state (in its articles if not in its governing statute) that it is carried on for a purpose otherwise than gain for its members and, upon liquidation/dissolution, its surplus assets will be distributed to other organizations for charitable

³⁵ If, however, the new Act were confined to pure NFP corporations, then its name should reflect that focus.

³⁶ Baz Edmeades observed that the term “non-distribution constraint” involves a double negative. Hence, this submission will generally refer to “distribution constraints”. See B. Edmeades “Formulating a Strategy for the Reform of Non-Profit Corporation Law – An Alberta Perspective” (1984), 22 Alta. L. Rev. 417.

purposes. No part of a charitable corporation's surplus assets will be ever be distributable to members. The same rules apply to all other mutual benefit corporations. This should be codified in the new Act.

A separate, significant issue is to what extent capital contributions (which represent a return of capital and not a distribution of surplus assets) may be distributed to members of a nonshare corporation. Members can lend money or assets to a nonshare corporation and should reasonably expect to have the loan repaid or the leased asset returned. Capital contributions are akin to loans in the sense that their return to the members ought not to be seen as violating any distribution constraint. The new Act should clarify what can and cannot be distributed to members.

With respect to mutual benefit or member corporations, a distinction must be made between true membership corporations (as defined above)³⁷ and other types of member corporations where there may be no reasonable expectation of receiving a distribution of surplus assets on a liquidation or dissolution. For a true membership corporation, where distributions are allowed to be made to members on liquidation/dissolution, it is logical to also allow such distributions when, for example, a member dies, is expelled or otherwise terminates his or her membership or when the member is oppressed to the point of having his or her membership constructively terminated. Distribution of surplus assets on liquidation/dissolution and other circumstances is an issue that requires comprehensive, coherent treatment under the new Act.

If the intention is to include all types of nonshare corporations within the new statute, a method of classifying the corporations for the purposes of the distribution constraint becomes necessary. One option is to leave the choice to the incorporators. Under this option, incorporators would, in effect, check the box to elect the default rules applicable to public benefit corporations or the default rules applicable on liquidation/dissolution/other events to mutual benefit corporations. All public benefit corporations would be able, in their articles, to elaborate or narrow the list of organizations carrying on similar activities to which assets may be distributed. In the case of charitable corporations, the list would be narrowed to other registered charities.³⁸

If the new Act were not to try to cover true membership corporations, then there would be no compelling reason to differentiate between public benefit corporations and mutual benefit corporations. For all NFP corporations, residual assets would never be distributed to members but instead would be distributed to organizations carrying on similar activities to those of the liquidating corporation.

4. Classification System

Should a classification scheme be developed for the new Act? If a classification scheme were developed, which classification system would be appropriate for the new Act: SK Act,

³⁷ See definitions at p. 3-4 above.

³⁸ Registered charities would include charitable foundations.

proposed revisions in Bill C-21, Alberta Volunteer Incorporations Act (Bill 54), OLRC Recommendation, California Corporations Code, ABA Model Act or another model? Should organizations be allowed to self-designate their classification? In what areas should different classes of corporations be subject to different rules?

There are two schools of thought within the JWG. Some think that new Ontario Act should not follow Bill C-21 but should develop a classification system. Others are of the mind that the new Act should reflect a unitary or non-classification model, perhaps applying different rules with respect to certain matters on the basis of whether the corporation seeks or obtains funding from government, charitable foundations or the public at large (as Bill C-21 would have done).

Adherents to a classification system think that the new Act should classify corporations as follows: public benefit; membership; and religious. To avoid confusion with the classification of charities under Canadian tax law and the provincial statutory and common law in relation to charities, the term “public benefit corporation” would be used rather than “charitable corporation” (as under the SK Act). Charitable status is obtained as a result of adherence to criteria outside of the corporate statute itself. However, being a public benefit corporation would be a first step to becoming recognized as a charitable corporation. The differentiation between these three classes of corporations would lie in the different governance and default rules that apply to each class.

For example, religious corporations require, as a minimum, perpetual existence and limited liability. If a religious corporation chooses to incorporate under the new Act, some other rules applicable to public benefit corporations could be optional (or even replaced with other rules), but all religious corporations would have basic mandatory or default rules.³⁹

Mutual benefit corporations involve a quasi-economic interest that would lead to a different set of default rules for them. For example, in a mutual benefit corporation, members could opt-in to the oppression remedy or dissent and appraisal rights. Golf, tennis and curling clubs are examples of member organizations that have a quasi-economic interest. The CBA is an example of a member organization that represents the collective professional (including economic and educational) interests of its members yet also carries out public interest activities by advancing proposals for improvement of legislation generally. However, membership in the CBA entails no economic interest *per se* in the net revenues or surplus assets of the organization and no *de facto* expectation by a CBA member of a meaningful return on liquidation/dissolution of the organization.

Classification might have to depend entirely on self-designation. Since defining the categories is difficult, if not impossible, there may be no practicable alternative to self-designation and this, coupled with inclusion of true membership corporations, may weaken the rules applicable to pure NFP corporations. The more disparate the types of nonshare corporations included within

³⁹ The statements in this paragraph represent the view of some members of the JWG. It is acknowledged that the area requires further study.

the purview of the new Act, the greater the flexibility that must be built into the applicable rules and the less reliance that can be placed on mandatory rules.

The contrasting view might be called “unitary”. This view posits that, for the most part, the new Act should not provide for different classes of nonshare corporations. Rather, the application of the rules must contain some built-in flexibility for the different types of corporations governed by the new Act or must apply based on criteria other than classification - especially self-designated classification. For example, audit exemptions would apply based on the annual revenues of the corporation, not on the basis of classification. This solution obviates the difficult problem of defining categories. Professor Hansmann expresses the unitary view strongly as follows:

In a misguided effort to meet the perceived needs of different types of nonprofit organizations – needs that, as it turns out, either have no legitimate basis, or could better be met through a well-designed cooperative corporation statute – nonprofit corporation law is today weak and fragmentary. In some cases, as with the Model Act, the law has tended to follow the lowest common denominator approach, applying to nearly all types of nonprofits the same minimal standards that have been thought appropriate for those organizations toward which the law should be most permissive. In other cases, as with the New York and California statutes, the law has proceeded to apply different standards to different types of nonprofits, with only slightly more satisfactory results.

I have suggested here, in contrast, that nonprofit corporation law should be both unitary and rigorous. All nonprofit corporations should be held to the same strict standards of fiduciary conduct toward their patrons. So long as nonprofit corporations are held to such standards, there should be no restrictions on the purposes that they may serve. There should be, in particular, no provision for special standards applicable to organizations that are classified as charitable, and the appeals that have been made, sometimes prominently, for a separate organizational law of charities should be rejected.⁴⁰

5. Corporate Powers and Capacity

Should NFP corporations be given the capacity, rights, powers and privileges of natural persons? If so, should the articles by a corporation be permitted to restrict its capacity, rights, powers and privileges? Should the capacity of a corporation continue to be governed by an *ultra vires* doctrine to the extent that limitations are placed on the powers of the corporation? If the new Act is not changed to provide corporations with the powers of natural persons, should the new Act specify that passage of by-laws continues to be required in order to confer powers on the corporations or its directors? Should the new Act adopt provisions similar to the OBCA and the ABA Model Act or another model to govern the capacity and powers of an NFP corporation?

As stated in Part 1 above, nonshare corporations should have the capacities, rights, powers and privileges of a natural person. The *ultra vires* doctrine should be abolished with respect to

⁴⁰ Hansmann, *supra*, footnote 30 at p. 622-3.

nonshare corporations as it long has been abolished for OBCA corporations. Bill C-21 and the SK Act provide useful models that abolish the *ultra vires* doctrine while, at the same time, allow a public benefit corporation to further restrict its permitted activities and powers so that it can qualify under tax legislation as a charitable corporation.

If a nonshare corporation is given the capacity and powers of a natural person, the list of implied statutory powers set out in the OCA would no longer be necessary.⁴¹

Under the new Act, by-laws should provide for internal regulations and should not be used to confer powers on the corporation or its directors.

For example, the power to borrow should be a default rule applicable to each nonshare corporation. A corporation would be entitled to restrict the default rule in its articles or by-laws. Further, the default rule would be that the directors of a nonshare corporation have the power to borrow and grant security on behalf of the corporation unless their authority is restricted in its articles or by-laws. The borrowing regime applicable to nonshare corporations should parallel that applicable to OBCA corporations.⁴²

Likewise, a nonshare corporation should be subject to the same statutory indoor management rule as applies to an OBCA corporation.

6. Other Issues

6.1 Directors and Officers Liability

Should a general duty of care and loyalty be formulated and incorporated into a statutory provision? What should the general standard be? Should a due diligence defence be included in the new Act? If so, what should be the scope of the due diligence defence? What should be permissible in terms of provisions relating to indemnification and liability insurance provided by NFP organizations to their fiduciaries? Should directors and officers be shielded from personal liability, subject to certain limitations? Should directors and officers liability be limited, for example, by caps on liability?

The duty of care and the duty of loyalty for directors of a nonshare corporation should be formulated to be consistent with the OBCA standard. Thus, a director or officer of a nonshare corporation should exercise the care, diligence and skill of a reasonably prudent person and should act honestly, in good faith and with a view to the best interests of the corporation. Directors and officers of a non-share corporation should owe their duties of loyalty and care exclusively to the corporation and not to members, patrons, creditors or third parties. Similarly,

⁴¹ OCA, *supra*, footnote 11, s. 23.

⁴² OBCA, s. 17 and ss. 184(1) and (2).

the OBCA good faith reliance defence ought to be extended to directors and officers of nonprofit corporations.⁴³

Given the typical lack of a direct financial interest of directors in the activities and affairs of nonshare corporations, it may, however, be that the duty of care imposed on directors and officers should be made an objective-subjective standard⁴⁴ rather than the objective standard for CBCA corporations enunciated by the Supreme Court in *Peoples Department Stores (Trustee of) v. Wise*.⁴⁵

Since directors of nonshare corporations have little or no prospect for personal gain, since the corporations themselves often cannot afford the premiums required to purchase policies of directors and officers liability insurance and there is a need to expand the pool of strong directors available to NFP corporations, favourable consideration should be given to shielding directors and officers from personal liability. An appropriate model might be s. 112.1 of the SK Act. As well, since 2003, Nova Scotia has legislation in force shielding directors, officers and other uncompensated persons from liability.⁴⁶

The OBCA provisions on indemnification and directors and officers insurance should likewise be mirrored in the new Act for directors and officers of Ontario nonshare corporations.

6.2 Financial Disclosure

What should be the required level of financial disclosure: disclosure to members, directors and officers; disclosure to a regulatory body; full financial disclosure to the public; partial disclosure to the public; or another level of disclosure? Should the level of financial disclosure required vary based on classification, type or size of organization?

There is a distinction between the level of audit for financial statements and the extent of disclosure. The new Act should create an appropriate default rule establishing which

⁴³ Including the enhanced protections that came into force on August 1, 2007 as a result of Bill 152, Sch. B.

⁴⁴ See, for example, *Soper v. R.* (1997), 149 D.L.R. (4th) 297 (Fed. C.A.), which held that the standard of care imposed on directors is inherently flexible. Rather than treating directors as a homogeneous group of professionals whose conduct is governed by a single, unchanging standard, the duty of care embraces a subjective standard that takes into account the personal knowledge and background of the directors, as well as his or her corporation's circumstances (such as the corporation's organization, resources, customs and conduct). Thus, more is expected of individuals with superior qualifications. However, the Supreme Court's interpretation of the duty of care in s. 122(1)(b) of the CBCA would apply equally in this respect to s. 134(1)(b) of the OBCA. *Soper* was effectively overruled by *Peoples*, *infra* footnote 45.

⁴⁵ [2004] 3 S.C.R. 461, 244 D.L.R. (4th) 564.

⁴⁶ *Volunteer Protection Act*, S.N.S. 2002, c.14. The scope of the Nova Scotia statute differs from the SK Act in several respects. First, the Nova Scotia Act applies to only certain types of non-profit organizations formed under the *Societies Act* (Nova Scotia) and to municipalities, school boards, regional library boards, hospitals, *etc.* It does not cover volunteers of unincorporated organizations. Second, it only appears to cover volunteers who receive compensation of less than \$500 a year. Third, it covers employees (as well as directors and officers) subject, however, to the \$500 compensation threshold. Section 112.1 of the SK Act applies to all directors, officers, employees and agents of a corporation incorporated under that Act irrespective of whether compensation is paid to such person.

corporations are required to have an audit or which corporations may instead rely on something less than an audit (either a review engagement or compilation) for its financial statements.

Financial reporting is integral to corporate governance and is needed to ensure transparency and accountability. It may be possible, however, to give corporations the option to present full or abbreviated financial disclosure to members.

It is not practicable to give every member of every nonshare corporation financial statements.⁴⁷ Where the corporation provides for a quasi-economic interest (as is the case for true membership corporations), then sending out financial statements may be appropriate. In other cases, it may suffice to post the financial statements on the corporation's website (perhaps on a page accessed through a membership identification or passcode) or, in other cases, only make the financial statements available to members upon request. Thus, the disclosure requirement should depend on the type of organization or the chosen provisions of the by-laws.

The *Charities Accounting Act* (Ontario)⁴⁸ provides for financial disclosure to a regulatory body (*i.e.* the PGT) upon demand or court order. However, that Act only applies to charities and other organizations having a public purpose.

Changes should be made to the *Charities Accounting Act* in conjunction with the new corporate statute so as to ensure legislative harmonization. In addition, the new Act should contain an enhanced conflict of interest regime for directors and officers of nonshare corporations which would address the contradictory interpretations of the case law regarding the compensation of a director for acting in another capacity with the corporation (such as the executive director of a charity who draws a salary).⁴⁹ The current restriction is based on PGT's interpretation of the case law and is not statute-based. Many commentators disagree with PGT's interpretation.

6.3 Members' Remedies

What types of remedies should members be entitled to under the new Act? Should the criteria for obtaining a compliance order under the new Act be broadened to require compliance with respect to the failure of directors to perform duties in addition to those set out in the new Act, such as duties imposed by by-laws? Should the oppression remedy be included in the new Act? Should the derivative action be included in the new Act? Should a right to dissent and appraisal with respect to members' fees be available under the new Act? Should a right to require mediation or binding arbitration be included in the new Act and, if so, in what circumstances? Should provisions be included in the new Act that

⁴⁷ 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.

⁴⁸ R.S.O. 1990, c. C.10.

⁴⁹ See footnote 25 on co-ordinating the new Act with the regulatory functions of the PGT. Note, however, that specific legislation such as the *Public Hospitals Act* (Ontario) may permit the executive director of a hospital to receive a salary even if she is on the hospital board.

provide for a fair hearing and natural justice where a corporation takes disciplinary action against a member?

Most of the remedies of members should be available by way of opt-in in the articles or by-laws because there are cost repercussions from a mandatory rule. With some nonshare organizations, there may be many active members who could create havoc for the organization. Even mediation could present problems for such an organization. The JWG thought that there would be a benefit to codifying in the new Act the current common law on the application of the principles of natural justice to proceedings involving the disciplining of members, including expulsion.

If the new Act is confined to pure NFP corporations, then the dissent and appraisal remedy would be inapplicable and the oppression remedy would have marginal utility at best.

It may be that the Attorney General could be used as a clearing house for certain member actions against corporations. Generally, however, we do not see an increased regulatory role as a satisfactory answer to enhancing director accountability.

The derivative action requires separate analysis. The derivative action is necessary to ensure that the duties of loyalty and care owed to the corporation are enforced other than by those in control of the corporation. There is a derivative action at common law.⁵⁰ Thus, there would be some benefit in codifying the derivative action along the lines found in the OBCA.

As stated above, there would also be a need for member-initiated compliance and restraining orders to, for example, ensure that the corporation complies with any restrictions on its permitted activities and powers, to enforce the distribution constraints and to police the director's duties of loyalty and care. We recognize that nonprofit corporations, by their nature, could suffer from the lack of financial incentives on the part of members to hold directors and officers to account. The accountability regime for NFP corporations is inherently weaker than for business corporations, and it may be an act of self-deception to assume that shareholder remedies that work well in a for-profit setting can be easily transposed into an NFP setting. Again, this is something that requires further study. In addition to membership election and removal of directors, other membership remedies appropriate to the NFP regime must be maintained, if not enhanced.

⁵⁰ See, for example, *Farnham v. Fingold*, [1973] 2 O.R. 132, 33 D.L.R. (3d) 156 (C.A.), holding, in that case, that the derivative action in the then new OBCA displaced any derivative or representative action available at common law.

SCHEDULE A

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SCHEDULE B

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