QUORUM AND CONFLICT OF INTEREST: HOW DOES THAT WORK?

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The Charity and Not-for-profit program titled “Board Issues under the new Not-for-profit Corporations Acts: Potential Problems and Practical Solutions” presented at the 2012 OBA Institute, was, in my view, a resounding success. Of course, I was one of the presenters so I may be a little biased, but I felt that the program was very nicely balanced and included some very timely and interesting topics. The participants also appeared to be very engaged, which resulted in a lively discussion during the panel question and answer session at the conclusion of the presentations.

I had the opportunity to present a paper entitled “The Ins and Outs of Voting”. In the presentation, I not only discussed the expanded methods of voting that are now allowed under the new legislation1, but I also discussed some practical issues that result from this flexibility. In addition to voting, I reviewed the rules about quorum and the types of meetings that will now be allowed under the new legislation.

The panel discussion at the end of the seminar raised some very interesting questions and elicited quite an interesting debate on a few points I touched on in my presentation. In this article, I thought it would be helpful to review the issue of loss of quorum at a meeting of the board of directors because of a declaration of conflict of interest.

Conflicts of Interest and Loss of Quorum

One of the general rules about quorum for directors meetings is this: quorum for directors’ meetings must be maintained throughout the meeting. If quorum is lost at any point, the meeting must be adjourned to a subsequent time when quorum is once again established, and the business from the adjourned meeting completed.

Using the following scenario as the basis for interpreting the new legislation, it is interesting to learn how different the legislation is in this area.

Scenario: The board of directors meets to review a contract that is material to the activities of the Corporation. The number of directors on the board is 7, quorum is a majority, and 4 directors attend the meeting. Quorum is established.

In the middle of the meeting a director realizes that the material contract the board is about to discuss is with a related party. He declares his interest immediately.

1 the Canada Not-for-profit Corporations Act which was proclaimed into force effective October 17, 2011, and the Not-for-profit Corporations Act, 2010, which has received Royal Assent but has not yet been proclaimed into force.
Without this director, the board has only 3 directors present at the meeting and quorum is lost.

What can the board do in this circumstance? Well, as I explained throughout my presentation in respect of a number of issues – it depends on the jurisdiction.

If the corporation is governed by the *Not-for-profit Corporations Act, 2010* (the “ONCA”), the meeting could continue, despite loss of quorum, in order to deal with the material contract. If the corporation is governed by the *Canada Not-for-profit Corporations Act* (the “CNCA”), quorum is lost and the decision about the material contract must either be adjourned to another time, or dealt with in another way.

Section 41 of the ONCA deals with disclosures of conflict of interest of directors and officers. The CNCA includes the rules in this regard in section 141.

Directors are required to disclose any direct or indirect interest the director has in a material contract or transaction. It would also be good practice for such disclosure to be included in the minutes of the meeting, whether or not the conflicted director requests such conflict to be included in the minutes.

Further, the director is not allowed vote on the matter. Interestingly, the ONCA requires that the director not attend any part of the meeting during which the contract is discussed, but the CNCA does not contain this same rule. However, in my view, it would be good practice for any director who is in a conflict, to leave the meeting and not participate in any discussion of the matter, in order to avoid any appearance of influencing the discussion on the matter.

Subsection 41(6) of the ONCA says that in such a situation, the remaining directors are *deemed* to constitute a quorum for the purposes of voting on the resolution. This is very helpful because it takes into consideration this precise situation. So, if a director has a conflict of interest, that director would declare the conflict and excuse him/herself from the meeting while the matter is discussed and voted on. Once the vote is concluded, the director may return to the meeting to participate in the remaining business of the meeting.

The CNCA is quite different. There is no deeming provision included in section 141. In my view, if a director has a conflict and quorum is lost as a result, the matter must be dealt with in some other way. I think that if the remaining directors attempted to consider the material contract, their decision and the validity of the material contract could be questioned and the decision quite possibly overturned.

Subsection 141(8) of the CNCA says that a contract or transaction for which disclosure is required is not invalid only because the director was present or was counted to determine whether a quorum existed at the meeting of directors. The following conditions must also be present in order for the contract to be valid: (a) disclosure was made in accordance with section 141, (b) the directors approved the contract; and (c) the contract was reasonable and fair to the corporation when it was approved.

Subsection 141(8) of the CNCA is concerned only with the validity of the contract and only states that the fact that the conflicted director is counted when determining quorum is not
relevant to whether or not the contract itself is valid. In my view, without a deeming provision such as is found in subsection 41(6) of the ONCA, one cannot leap to the conclusion that quorum would continue in such circumstances.

These particular sections of the ONCA and the CNCA mirror the provisions in the Business Corporations Act (Ontario) and the Canada Business Corporations Act in this regard. The deemed quorum rule was added to the Business Corporations Act (Ontario) in 2006. The case law from the business law field is quite helpful in interpreting both sections, as is the commentary related to the enactment of these provisions in the business law legislation.

What can a board of directors do in the circumstances?

- Under the ONCA, the board of directors could proceed, despite the lack of quorum.
- The matter could be adjourned to a subsequent meeting of the directors where quorum can be established without including the conflicted directors.
- The contract or transaction could be submitted to the members for confirmation by special resolution, as long as the provisions of subsection 41(10) of the ONCA and subsection 141(9) of the CNCA, as applicable, are followed.
- The written resolution may be employed in this circumstance, as long as all of the conditions related to written resolutions apply.

A word about the Written Resolution

A written resolution is as valid as if it had been passed at a meeting of directors (or members as the case may be) as long as it is signed by all who are entitled to vote on the resolution at a meeting (see ONCA, ss. 35(1) – directors; ss. 59(1) – members; CNCA, s. 166).

A written resolution includes the element of unanimity, meaning that majority rule and quorum do not apply: every director (or member as the case may be) must sign the resolution in order for the resolution to be valid. Continuing with the above scenario, it is insufficient for all of the directors present at the meeting in question to sign the resolution in order to meet the requirement; all directors not present at the meeting must also sign the resolution. The only individuals that may not sign the resolution are the directors who have disclosed their conflict of interest.

The rule also contemplates conflicts because of the wording “... who are entitled to vote on the resolution at a meeting”. This means that if a director is not allowed to vote on a resolution at a meeting because he/she has disclosed his/her interest in the matter, he/she is also not allowed to sign the written resolution in lieu thereof.

As a practical matter, I include a signing line for the conflicted director and indicate the disclosure of the conflict on that signing line. Including a footnote to indicate which director had declared a conflict of interest on the matter avoids questions of validity of the resolution in the future.

The written resolution is not appropriate in every situation. There are many situations that require a fulsome discussion and debate and the written resolution may not be the right way to conduct the business of the board in every instance. However, it is a useful tool that I think may be utilized more frequently in the not-for-profit sector.
A word about Fairness

Another matter that needs to be considered is the appropriateness of a very small number of directors approving a material contract or transaction. In the above scenario, there are 7 directors. If only 3 of those directors vote on the resolution, the result could be that the matter is decided by only 2 out of 7 directors. Is this appropriate? Is it fair?

Again, I encourage you to review the significant case law in the business law context in this subject area.

There may be instances where the rules of the legislation provide the technical means to achieve something, but is it fair or appropriate in the circumstances.

Conclusion

As I advised during my presentation, the new legislation provides additional flexibility in respect of methods of holding meetings, and voting at such meetings. However, there are many issues that also must be addressed. A careful read of the legislation, and an understanding of the differences between the ONCA and the CNCA, is required in order for us to properly advise our clients.

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