MINISTRY OF GOVERNMENT SERVICES
Policy and Consumer Protection Services Division

CONSULTATION PAPER

Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations

May 7, 2007

Ontario

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Corporations Act Reform Process

The Ministry of Government Services is undertaking a project to review and reform the Ontario *Corporations Act* (CA). The purpose of the project is to develop a new legal framework to govern the structure and activities of charities and not-for-profit corporations. The purpose of this discussion paper is to invite comments and suggestions from stakeholders and from the public regarding the reform of this important legislation. Additional discussion papers will be released in the future to generate feedback on more specific issues. The Ministry intends to use the results of these consultations to develop new not-for-profit legislation.

The current *Corporations Act* provides the statutory framework governing the creation, governance and dissolution of not-for-profit corporations, including charitable corporations. In addition, it provides the legislation under which insurance companies in Ontario are incorporated and find their basic corporate governance rules. It should be noted that the CA is an organizational statute, and not a regulatory statute. In other words, enforcement of the rights and duties under the statute lies primarily with the corporation, its directors and its members. Hence, the focus of this consultation is not on the regulation of charitable or other not-for-profit corporations.

This paper requests comments on broad issues relating to new not-for-profit legislation, including the following:

- Structure of a new not-for-profit Act
- Incorporation Process
- Definition of Not-For-Profit Corporation
- Classification System
- Corporate Powers and Capacity
- Other Issues: Directors' Liability, Financial Disclosure, Members' Remedies

The Ministry kindly requests your input, views and feedback on the issues outlined below.

The Ministry has provided some background material and some questions for consideration**.**

Respondents are not restricted to consideration of only the questions listed below. Please feel free to share any viewpoints and other perspectives that you feel are appropriate.

Please respond by July 31st, 2007 electronically or in writing, to:

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Introduction

Background on Not-for-Profit Organizations

Not-for-profit organizations are dedicated to objectives other than the pursuit of profit. Not-for-profit organizations encompass both charitable not-for-profit organizations (such as medical research associations, museums, crisis centres, and hostels), and non-charitable not-for-profit organizations (such as trade associations, social clubs and athletic organizations).

Not-for-profit organizations are very diverse, in both their areas of activity and in their organizational characteristics. Underlying their differences is a common characteristic - they are instruments for collective action and engagement in civic life. With their broad scope of activities, not-for-profit organizations work to address the full range of human needs, improving the quality of life and providing essential services. For example, they provide social services, ranging from day-care centres for children and services for youth to caring for seniors. They also provide opportunities for Canadians to become engaged in their communities by participating in sports, recreation or the arts or by addressing social and environmental issues.

Canada has one of the largest not-for-profit sectors in the world, taking in about $9 billion in individual donations each year from some 22 million Canadians. Statistics Canada estimates that the not-for-profit and voluntary sector contributes $112 billion to the Canadian economy each year. The sector employs more than 2 million full-time workers and has approximately 19 million volunteer positions. Volunteerism is so predominant in this sector that studies indicate it is the equivalent of one million full-time jobs and roughly equivalent to 12.1% of the Canadian labour force.

One of the distinguishing features of many not-for-profit organizations is that they are collectively “owned” by their members, who do not receive a share in any revenues that their organizations may generate. Any profits or funds that those organizations receive are not distributed to the organization’s members but are to be used to further the not-for-profit objectives of the organization. The membership of most organizations is composed of individual people; for others, membership is typically made up of other organizations.

Charitable and not-for-profit concerns developed in various countries where religion, education, health and relief of poverty were deemed to be charitable endeavours. More recently, services that benefit the community have been added as a category by the courts in their interpretation of the common law definition of a charity. Charities are a special type of not-for-profit organization. Charities can obtain registered status with the Canada Revenue Agency if they satisfy the requirements in the *Income Tax Act* (Canada). Not all charities must be registered, but registration confers benefits such as tax incentives to donors for the donations they make, and enables those organizations to access funding from charitable foundations which is restricted by law to registered charities and a small number of “qualified donees”.

Not-for-profit organizations can take 3 forms: unincorporated association, charitable trust, and the not-for-profit corporation. This paper focuses on the not-for-profit corporation. The CA governs the creation, governance and dissolution of most not-for-profit corporations in Ontario, including charitable corporations. Unlike other not-for-profit corporations, charitable corporations are subject to regulation by the Office of the Public Guardian and Trustee of the Ministry of the Attorney General, which operates under the authority of the *Charities Accounting Act* and the *Charitable Gifts Act*. Charitable corporations are also governed by other legislation,

including the *Charitable Institutions Act* and the *Income Tax Act* (Canada). Generally, not-for-profit organizations are exempt from tax on their income.

Need for Reform

The current statutory regime governing not-for-profit corporations in Ontario required updating. The original version of the statute was enacted in 1907 (the *Companies Act*) and was last substantially revised in 1953. Since that time, there has been no significant revision to the CA. Concerns have been raised that the CA is antiquated, cumbersome and does not statutorily meet the requirements of the modern not-for-profit sector.

At present, there are over 50,000 not-for-profit corporations active in Ontario under the CA. Many of these corporations undertake a myriad of activities, generate significant economic activity, employ thousands of workers, and rely on countless volunteers. Most observers of the not-for-profit sector recognize that many not-for-profits are governed differently, have expanded their economic influence and are branching into the delivery of services vastly different from how they operated in 1953. Similar to the concern raised above about the antiquated nature of the statute, the current legal framework governing not-for-profits has also not kept pace with the innovativeness of the sector. Members of the public and not-for-profits also recognize the necessity to provide ever-increasing protection to the charitable contributions of donors, volunteers on not-for-profit boards, and broader remedies for members.

The reform project envisages modernization to allow not-for-profit organizations to incorporate and govern themselves more efficiently and effectively. It may also benefit the non-profit corporations governed by Ontario's Co-operative Corporations Act. In addition, reform of the CA provides the opportunity to examine integrating the legislation governing Ontario's insurance companies with more appropriate legislation.

Objectives of Reform

The objective of the reform is to respond to the realities of the 21st century not-for-profit sector by creating a new strengthened legal framework for members of not-for-profit corporations, the public who utilize not-for-profit services, and contributors to charitable initiatives.

It is our goal that reform of the CA will achieve the following objectives:

- To provide more flexible and up-to-date rules for dealing with the relationship between the corporation and its directors, officers, and members
- To provide improved corporate governance and accountability
- To provide efficient means for incorporation and operation of not-for-profit corporations
- To create more comprehensive legislation that will address gaps in the current legislation
- To enable activity by a diversity of not-for-profit corporations
- To streamline operational and administrative requirements and improve the processing efficiency of applications for not-for-profit corporations

1. Incorporation Process

Should the Ontario *Corporations Act* move from a letters patent system of incorporation to a system of incorporation "as of right"?

Background

Not-for-profit corporations can be incorporated in Ontario through the filing of an application for letters patent (old form of incorporation document where the government has total discretion to allow a particular corporation to incorporate) under the CA with supporting documents and payment of the required fee. Unlike the Ontario *Business Corporations Act*, the CA does not provide for endorsement as of right; instead, not-for-profit corporations are incorporated at the discretion of the Ministry of Government Services. Ministry staff conduct reviews of the applications and have authority under the statute to require revisions to the objects or purposes of the corporation if they appear to fall outside the scope of the statute (i.e. the objects and purposes must be not-for-profit). The letters patent are placed on the public record, as are any fundamental changes and dissolution. [s. 4(1) and s. 9]

Where charitable objects are involved, the Ministry has had an administrative policy of requiring prior consent of the Office of the Public Guardian and Trustee (PGT). The PGT's policy is that it will deny consent for an application for incorporation based on certain factors, for example objects that are not exclusively charitable, or objects that are too broad or vague. The PGT also requires that certain provisions be placed in the powers clause of the incorporating document. The fact that incorporation of a not-for-profit corporation is a discretionary act has allowed for development in Ontario of administrative practices that permit government officials to impose certain restrictions in the public interest on the incorporation of not-for-profit corporations.

Since the main aim of organizational law is to facilitate not-for-profit activity, unnecessary barriers restricting access to the use of the corporate form by not-for-profit organizations should be minimized. Many jurisdictions now permit not-for-profit corporations to incorporate "as of right", subject to certain statutory conditions that are imposed administratively, such as restrictions on corporate names. Incorporation "as of right" means that a not-for-profit organization may be incorporated at the time of filing the documents and submitting the fees prescribed by law. If certain basic legal requirements are satisfied, the Ministry would not be able to decline to issue a certificate of incorporation but will only be able to insist on receiving those documents and fees prescribed by law.

Incorporation "as of right" would limit the scope of the Ministry's review and could expedite the incorporation process. Some commentators indicate that without Ministerial approval of a corporation's constating documents (i.e. the incorporation documents and all related documents, including any supplementary letters patent), errors and ambiguities on those documents could go unnoticed. These could result in an increasing need to rectify errors after incorporation and even the possibility that invalid corporations could be operating in the province. For instance, to qualify as a charitable corporation, its objects must satisfy strict legal requirements. As the legal meaning of "charity" is much narrower than the popular meaning of the word, applicants may establish a corporation mistakenly believing it to be a charity when it is not.

Other Jurisdictions and Models

All business corporations statutes in Canada allow incorporation "as of right". The not-for-profit corporations statutes of Saskatchewan, New York, and California allow incorporation "as of right". Bill C-21: *Canada Not-for-profit Corporations Act*[1] also proposed to allow incorporation "as of right".

Questions

- 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?

[1] The previous federal government introduced successor legislation to the *Canada Corporations Act* under Bill C-21, *Canada Not-for-profit Corporations Act*. This Bill died on the Order Paper on November 29, 2005 when the 38th Parliament was dissolved. The future of this draft legislation is uncertain. However, the Bill may give a general sense as to the direction the law may take if the Bill is re-introduced in similar form in the future. This paper will reference provisions in Bill C-21 for discussion purposes.

2. Structure of the Ontario *Corporations Act*

How should the Ontario *Corporations Act* be structured?

Background

The current structure of the CA is difficult to navigate. If a new structure is adopted, there are two basic forms that it can take.

Other Jurisdictions and Models

Ontario *Business Corporations Act* (OBCA)

The majority of the OBCA is written to apply to every type of corporation incorporated under it, with exceptions and limitations spelled out in each particular section. The structure of the OBCA is widely familiar to those who deal with Ontario business corporations. This approach is used in business and not-for-profit corporations statutes in Canada and was proposed in Bill C-21, *Canada Not-for-profit Corporations Act*.

California Corporations Code

The *California Corporations Code* is divided into a general part with provisions and definitions that apply to all corporations incorporated under it, and specific parts for designated types of not-for-profit corporations. This structure might be easier to use and understand since the user can readily identify all of the provisions respecting a particular type of corporation without the need to use or know the entire statute. However, such a structure could result in a lengthier statute overall.

Questions

- Should the CA follow the structure of the Ontario *Business Corporations Act* and the provisions proposed in Bill C-21, *Canada Not-for-profit Corporations Act*; the *California Corporations Code*; or another structure?

3. Definition of a Not-for-profit Corporation

How should not-for-profit corporations be defined?

Background

The definition of not-for-profit corporation includes two components:

1. Not-for-profit purpose: Not-for-profit corporations pursue purposes other than profit or the pecuniary advantage of their members.

2. Non-distribution constraint: Not-for-profit corporations are not business or commercial entities and they do not make distributions of their property to their members, at least not prior to dissolution.

The following section will examine the two components of the definition of not-for-profit corporation.

3.1 Not-for-Profit Purpose

3.1.1 Clarification of Purposes

Issue: Should the CA clarify the permitted purposes of not-for-profit corporations?

Background

As the scope of activity engaged in by not-for-profit corporations becomes increasingly broad, it might be desirable to clearly define the permitted purposes and activities of those corporations. A not-for-profit corporation can be incorporated with any "objects that are within the jurisdiction of Ontario". [s. 118] Prior to amendments made in 1994 to s. 118 of the CA, it contained a list of objects of not-for-profit corporations, including "patriotic, religious, philanthropic, charitable, educational, agricultural, scientific, artistic, social, professional, fraternal, sporting or athletic nature, or that are of any other useful nature". In 1994, amendments were made to s. 118 to accommodate certain corporations that were intended to benefit communities at large, but might have been determined to fall outside of the permitted objects of s. 118 on a narrow interpretation of that section (e.g. airport authorities, aboriginal economic development corporations).

The CA also specifies that a not-for-profit corporation "shall be carried on without the purpose of gain for its members". Any profits or other funds of the corporation must be used in promoting its objects. However, directors and officers are allowed to receive reasonable remuneration and expenses for services as director or officer, and/or for services in any other capacity, unless prohibited by letters patent or bylaws. [s. 126]

The current provisions are not explicit as to what is intended by the prohibition on "gains for its members". The CA could be clarified to exclude gains in any form, such that the CA would preclude the incorporation of associations that indirectly advance the pecuniary interest of their members by advancing a common interest (e.g. trade associations). This would represent a

shift from the current application of the CA, under which trade associations are permitted to incorporate as not-for-profit corporations.

Alternatively, the prohibition could be clarified to preclude only the distribution of profits to members through dividends or some other form of direct distribution, and to preclude profit-making activities except as incidental to the principal not-for-profit purposes unless there is an over-riding public benefit (e.g., airport authorities, aboriginal economic development corporations). This has generally been the manner in which the provision has been interpreted.

Other Jurisdictions/Models

In not-for-profit corporation statutes that allow for multiple classes of corporations, each particular class is defined in the statute and all corporations must fall within the definition of one of those classes. Examples of multiple class statutes include the Saskatchewan *Non-profit Corporations Act, 1995*, the *California Corporations Code*, and the U.S. Revised Model Nonprofit Corporation Act (1987). In the Saskatchewan statute, for example, a corporation must either fall within the definition of a "membership corporation" or a "charitable corporation". The classification system for not-for-profit corporations statutes is discussed in more detail in section 4 below.

Many Canadian not-for-profit corporations statutes, which do not distinguish between different classes of not-for-profit corporations, continue to provide either a complete or an exhaustive list of purposes for which not-for-profit corporations can be incorporated.

Bill C-21: *Canada-not-for-profit Corporations Act* proposed that one of the purposes of that statute is to allow for the incorporation or continuance of corporations without share capital for "the purposes of carrying on legal activities". [s. 4]

Questions

- Should the CA clarify the permitted purposes of not-for-profit corporations? If so, how?
- Should the CA contain a list of permitted purposes of not-for-profit corporations? If so, what should be included in the list of permitted purposes?
- Should the CA prohibit certain purposes of not-for-profit corporations? If so, what purposes should not-for-profit corporations be prohibited from undertaking?
- If a classification system is adopted in the CA, should permitted purposes of not-for-profit corporations be tied to the definitions of the various classes?

3.1.2 For-Profit Activities

Issue: Should the CA regulate for-profit/commercial activities undertaken by not-for-profit corporations?

Background

For-profit activities occur in not-for-profit corporations that have the organizational capacities and assets that can be used effectively to generate profit that can then be returned to the

corporation. Examples of for-profit activities in the not-for-profit sector include museum gift shops, hospital parking lots, the provision of market-priced services by charitable home care organizations, the sale of products that are closely identified with the corporation or are sold by agents of the corporation, and the marketing of intangible assets, such as product endorsements by a not-for-profit corporation.

Generally, for-profit activities undertaken by not-for-profit corporations are incidental to the stated purposes of those corporations, and the profits from commercial activities are used by the corporations to advance those purposes. The CA is not explicit on whether or not not-for-profit corporations can carry on incidental commercial activities. Apart from restrictions imposed by the "non-distribution constraint" and the "not-for-profit purpose" requirement on not-for-profit corporations, however, it is believed that those corporations generally have few legal limitations on the kinds of activities that they may pursue. The CA has generally been applied to mean that a not-for-profit corporation may engage in activities that produce a profit, provided that those activities are incidental to the principal objects of the corporation and in furtherance of them. Limits to commercial activity by not-for-profit corporations could also arise from strategic, social legitimacy, and public relations concerns.

For-profit or business activities are already regulated to some extent by other statutes. The *Income Tax Act* (Canada) prohibits not-for-profit corporations that fall within the definition of s. 149(1)(l) of that Act from having profit making as an objective. In the case of registered charities other than private foundations, they can carry on a "related business", i.e., one that is related to their charitable objectives. Charitable organizations and public foundations are also allowed to run businesses where substantially all persons employed by the charity in the carrying on of that business are not remunerated for that employment. The *Charitable Gifts Act* places restrictions on the business and investment activities of charities. In particular, it prohibits most charities in Ontario from holding on to a charitable gift that consists of more than a 10% interest in any business. [s. 2(1)]

Some issues to consider when determining the appropriate legislative action, if any, with respect to the for-profit activities of not-for-profit corporations are the effects that for-profit activities have on the objectives and values of not-for-profit corporations, and the possibility of "unfair competition" with for-profit businesses. "Unfair competition" might exist because of certain tax advantages that not-for-profit corporations have over their for-profit business competitors. Not-for-profit corporations also benefit from their standing and reputation as organizations that operate for the public benefit. "Unfair competition" is a legitimate concern of for-profit businesses; however, special treatment of not-for-profit corporations might be justified since the profits earned are at least partly used to subsidize the corporation's not-for-profit activities. Economic implications of business activity by not-for-profit corporations (e.g. the transfer of business activity from business corporations to not-for-profit corporations) are also relevant, but are beyond the scope of this paper.

Other Jurisdictions and Models

Non-Commercial Purpose Constraint

One approach to regulating for-profit activities is to include a well-defined non-commercial purpose constraint in the CA that excludes commercial activity as a dominant purpose of all not-for-profit corporations. This would allow not-for-profit organizations to be formed for any purpose normally carried on by for-profit corporations, but require that the principal purpose of

the organization be something other than operating a business. Any further regulation of commercial activities of not-for-profit corporations would be left to regulatory statutes.

This approach is based on the reasoning that not-for-profit corporations should not be prohibited from carrying on commercial activities, provided the activities are ancillary and incidental to their not-for-profit purpose, and profits earned are all applied to the main purposes of the corporation. This approach was recommended by the Ontario Law Reform Commission in its 1996 "Report on the Law of Charities". The New York *Not-For-Profit Corporation Law* allows "Type C" corporations to be incorporated to carry on in this manner. [s. 201(b)]

Mandatory Use of Subsidiary

Another approach would be to require that not-for-profit corporations that engage in commercial activity must do so through a for-profit subsidiary subject to the same laws and regulations that apply to for-profit firms with which they compete. When for-profit firms offer essentially the same goods and services in the market and are harmed by "unfair competition" by not-for-profit corporations, the not-for-profit activity should be deemed commercial in nature and operated through a for-profit subsidiary. This approach is intended to eliminate "unfair competition", separate the charitable and public service components of not-for-profits from their commercial operations, and explicitly recognize that their charitable and commercial functions are fundamentally different.

However, this approach may not work for charities, as the *Charitable Gifts Act* restricts most of them from owning, directly or indirectly, more than a 10 % interest in any business. Accordingly, it does not appear to be legally possible for a charitable corporation to have a for-profit subsidiary. Ownership of for-profit subsidiaries by not-for-profit corporations could also still allow for the existence of "unfair competition". For instance, "unfair competition" could continue to occur where parent not-for-profit corporations subsidize their for-profit subsidiaries with the money, time, or resources of a tax-exempt entity, or where a parent corporation transfers competitively sensitive information to subsidiaries. Several options have been suggested to mitigate these potential problems, including requiring not-for-profit parent corporations and their for-profit subsidiaries to operate at arm's length, requiring parent and subsidiary corporations to produce separate financial statements, or requiring subsidiary corporations to incorporate separately, for example, under Ontario *Business Corporations Act*.

Restriction On Size of For-Profit Undertaking
A third approach would allow for-profit activities, but would put a restriction on the size of the undertaking (e.g., a percentage of their operating budget). This would ensure that for-profit activities do not overtake the not-for-profit focus of the corporation. Not-for-profit corporations would be allowed to undertake profitable operations up to a specified level, beyond which they would lose their status as a not-for-profit entity.

Exceptions
If restrictions are placed on the business activities of not-for-profit corporations, it is necessary to consider whether or not exceptions should be provided in certain cases. For example, an exception might be provided in the case of aboriginal economic development corporations, whose profits are intended to benefit an entire community.

Questions

- Should the CA regulate for-profit/commercial activities undertaken by not-for-profit corporations?
- Should for-profit/commercial activities be regulated through a non-commercial purpose constraint, the mandatory use of a subsidiary to carry on for-profit activities, a restriction on the size of the for-profit undertaking, or by another method?
- If for-profit/commercial activities are regulated, should certain not-for-profit corporations be entitled to exemptions where their activities are for the benefit of an entire community (e.g. aboriginal economic development corporations)?

3.2 Non-Distribution Constraint

Background

As discussed in section 3.1.1 above, the CA specifies that a not-for-profit corporation “shall be carried on without the purpose of gain for its members”. [s. 126] This is likely intended to have the effect of a general non-distribution constraint, however its wording is not explicit.

With regards to distribution of assets upon the dissolution of a corporation, the CA permits a corporation to pass by-laws providing that, upon its dissolution and after payment of all of its debts and liabilities, its remaining property shall be distributed to the provincial or federal governments, municipal corporations, charitable organizations or organizations whose purposes are beneficial to the community. If there are no bylaws passed to that effect, then upon the dissolution of the corporation, all of its remaining property shall be distributed equally among the members, or if the letters patent, supplementary letters patent or by-laws so provide, among the members of a class or classes of members. [s. 132] This provision causes some confusion in connection with charitable corporations, as the common law prohibits them from distributing their funds to their members.

Subsection 126 (2) specifically authorizes payments to directors unless the letters patent, supplementary letters patent or by-laws otherwise provide. This provision is subject to the common law, which prohibits directors of charities from receiving remuneration for their services in any capacity, without the approval of the court.

Charitable and other corporations that receive funds from the public or from the government are subject to the terms of funding agreements that impose restrictions on the distribution of property to the corporation's members, and typically require that any distributions permitted to be made are made to another charity or not-for-profit corporation with similar objects. In addition, as a matter of policy, the Office of the Public Guardian and Trustee (PGT) requires that a standard non-distribution clause prohibiting distribution of funds to members be included in each charitable corporation's special provisions before the PGT will grant its approval. In practice, however, improper distributions of property by charitable corporations are difficult to recover once the funds have been distributed.

Other Jurisdictions and Models

Saskatchewan *Non-Profit Corporations Act, 1995*
The Saskatchewan statute sets out the types of distributions that are permissible while creating a general prohibition against distributions to members, directors, and officers. The Saskatchewan statute prohibits distributions of profits or increases in property value to members, directors and officers except in the form of indemnification from the cost of lawsuits, remuneration for services, payment of the fair market value for membership interests pursuant to the dissent right and in the case of applications to court regarding the oppression remedy or corporate records. The Saskatchewan statute also includes a provision that allows transfers to a subsidiary corporation that is authorized to carry on the works of the parent organization. [s. 30]

Upon dissolution, the remaining property of a "membership corporation" is distributed in accordance with its articles, or if the articles are silent, the property is distributed to members in equal shares. The remaining property of a "charitable corporation" is distributed in accordance with its articles if the articles provide for the transfer of property to another charity or to the government. If the articles of a "charitable corporation" do not so provide, then the remaining property is transferred to a corporation carrying on the same or similar activities, to another charity, or to the government. [s. 209]

Bill C-21: *Canada Not-for-profit Corporations Act*
Bill C-21 proposed that not-for-profit corporations would generally be prohibited from distributing corporate profits, property or accretions to property value to its members, directors, or officers, except in furtherance of their activities or as permitted by the Bill. [s. 35(1)] If a member of a corporation is an entity authorized to carry on activities on the not-for-profit corporation's behalf, the corporation may distribute money or property to the entity to allow it to carry on authorized activities on the corporation's behalf. [s. 35(2)]

Upon dissolution, a corporation that is a registered charity under the *Income Tax Act* (Canada), a "soliciting corporation", or a corporation that has requested donations from the public, received funding from the government or received funds from other corporations who have done so, would be required to distribute any remaining property to one or more "qualified donees" within the meaning of s. 248(1) of the *Income Tax Act* (Canada). [s. 233] The remaining property of a corporation that does not fall within the purview of s. 233 would be required to be distributed in accordance with its articles, or if the articles are silent, then the property would be distributed to members in equal shares.

Ontario Law Reform Commission Recommendation
In its 1996 "Report on the Law of Charities", the Ontario Law Reform Commission recommended 2 non-distribution constraint rules to be put in place of the current prohibition on gains for a corporation's members:

1. Prohibit distributions to members and to members of a broadly defined prescribed class of related persons during the existence of the corporation. This rule would apply to all corporations.

2. Prohibit distributions to members or members of a prescribed class on dissolution. This rule would apply only to religious and charitable corporations.

This recommendation assumes the existence of a multi-class system in the CA. "Distribution" in those two rules would be defined widely as any non-compensated advantage or benefit to members or members of a prescribed class. There would be an exception to the rules that would permit corporations to provide distress or poor relief to members, make grants to members to carry on a corporation's work, and permit a mutual benefit corporation to repurchase memberships, if solvent.

Questions

- 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 CA model its non-distribution constraint on the Saskatchewan *Non-Profit Corporations Act, 1995*, proposed provisions in Bill C-21, *Canada Not-for-profit Corporations Act*, the Ontario Law Reform Commission recommendation, or another model?

4. Classification System

Should a classification system that provides for multiple classes of not-for-profit corporations be included in the Ontario *Corporations Act*?

Background

Currently, the CA provides for only one class of not-for-profit corporation, which can have "objects that are within the jurisdiction of the Province of Ontario". [s. 118]

Due to the diversity of not-for-profit corporations in terms of membership, purposes, and sources of funding, a classification system that provides for multiple classes of not-for-profit corporations has been suggested. A classification system with multiple classes could potentially meet the needs of each of the various types of not-for-profit corporations more adequately. In such a system, the majority of provisions in the CA would still apply equally to all not-for-profit corporations.

A potential problem with the multiple class system is that it could lead to confusion and wrongly classified organizations. Difficulties in classification could arise in cases such as service clubs and religious and ethnic organizations, which can have some public benefit purposes and some membership benefit purposes.

Other Jurisdictions and Models

A) Classification Models

The following classification models have been identified for discussion:

Saskatchewan *Non-Profit Corporations Act, 1995*
The Saskatchewan statute contains the following classifications:

- Charitable corporation: Carries on activities that are primarily for the benefit of the public, carries on activities that are not primarily for the benefit of its members, solicits donations from the public, receives funds from the government in excess of 10% of the income for that fiscal year, or is a registered charity within the meaning of the *Income Tax Act* (Canada). [ss. 2(1) and 2(9)] This definition includes a substantial number of corporations that are not considered charitable at common law.
- Membership corporation: Carries on activities primarily for the benefit of its members. [s. 2(1)] All organizations that do not qualify as charities are categorized as membership organizations.

The classifications are used in the application of rules that regulate fundamental changes and the non-distribution constraint. With respect to fundamental changes, the power of a "charitable corporation" to amend its articles is strictly controlled. Subject to a minor exception, after the amendment the corporation must continue to be charitable [s. 116(3)] and, in some cases, prior court approval is required. [s. 161] With respect to the non-distribution constraint, distribution of assets of a "charitable corporation" on dissolution are restricted to ensure their continue dedication to charitable purposes. [s. 209]

Bill C-21, *Canada Not-for-profit Corporations Act*
Bill C-21 proposed the following classifications:

- Soliciting corporation: Solicits funds from public, government or other entity, and includes charities.
- Non-soliciting corporation

The distinction between classes in Bill C-21 is relevant with regard to the additional rules for soliciting corporations relating to the requirement for a minimum number of directors, the ability to make use of unanimous member agreements, the requirement to provide financial statements to the director, the requirement to appoint a public accountant, and the distribution of property upon dissolution.

Bill 54, Alberta *Volunteer Incorporations Act* (1987)
Classification in the Alberta statute is based on types of financial distributions that organizations could make. The Alberta statute requires that the articles of incorporation must contain one of the following provisions [s. 5]:

(a) A provision that no income or property of the incorporated association shall be distributed to a member, director or officer except on or after the liquidation of the unincorporated association. (This provision would be used by incorporators where the main object of the corporation was to benefit members.)

(b) A provision that no income or property of the incorporated association shall be distributed to a member, director or officer either during the existence of the incorporated association or on or after its liquidation. (This provision would be used by incorporators in cases where the object was to benefit the public.)

The Bill also contains a further classification of "soliciting incorporated associations", which includes corporations that have solicited money from the public, or received a grant or similar financial assistance from a government. [s. 1(1), (2)] These organizations are prohibited from changing their purposes without the permission of the court [s.80(4)], they must have at least 3 directors instead of one [s.42(2)], and they are required to have an auditor [s.68(2)].

Ontario Law Reform Commission Recommendation
The Ontario Law Reform Commission recommended in its 1996 "Report on the Law of Charities" that the following classes be included in the CA:

- Religious
- Charities
- Political
- Mutual benefit
- General not-for-profit

The distinction between classes in this model is relevant with regard to the non-distribution constraint rules, the qualifications of the incorporators, the transferability and repurchase of memberships, members rights and remedies, the requirement for a minimum number of directors, the qualifications of directors, and approval requirements for amendments to articles, asset sales and dissolutions. This classification system allows political organizations to be established under their own heading, and provides a classification for organizations that do not neatly fit into one of the other four categories.

California *Corporations Code* and American Bar Association's Revised Model Act
The California statute and the Model Act contain the following classifications:

- Mutual benefit: Organizations that primarily serve the interests of their members.
- Public Benefit: Includes charities that are not religious organizations.
- Religious

The function of the classifications is to provide different levels of regulation in the not-for-profit corporation statutes. Public benefit corporations are the most highly regulated, while the least regulated are the mutual benefit and religious corporations. For example, no corporations are allowed to make distributions while they exist; public benefit and religious corporations may not dissolve without the permission of the Attorney General. This is the classification system used in most jurisdictions in the United States.

B) Areas of Differentiation Among Classes

If a classification system were adopted, it would be necessary to determine the areas in which the classes of not-for-profit corporations would be treated differently. The following are examples of areas where different classes could be treated differently.

1. Distribution of assets upon dissolution: Upon dissolution, which classes of corporations should be permitted to distribute its assets to members, to non-charitable not-for-profit organizations with similar objects, to charitable organizations, etc.?

2. Payment of remuneration: While directors of charities cannot receive remuneration or enter into contracts with the charity without court approval, no such limitations apply to other not-for-profits. Should existing limitations on remuneration for directors of charities be codified in the statute?

3. Transferability of memberships: Should members of certain classes of corporations be permitted to or restricted from transferring their memberships to others?

4. Repurchase of memberships by the corporation: Should certain classes of corporations be permitted to or restricted from repurchasing memberships from its members?

5. Members' rights and remedies: Should members of different classes of corporations have different access to rights and remedies, such as governance rights, dissent and appraisal rights, derivative action rights, oppression remedy rights, and a process of dismissal that complies with the rules of natural justice?

6. Members' rights on fundamental changes: Should members of different classes of corporations have access to different rights with regard to fundamental changes, such as amendments to corporation's constitution?

7. Prohibitions or restrictions on amalgamations: Should certain classes be prohibited or restricted from amalgamating with certain organizations, such as non-public benefit corporations or commercial corporations?

8. Fiduciary obligations of directors and officers: Should fiduciary obligations of directors and officers in certain classes, for example charitable or public benefit corporations, be higher than those of other classes?

9. Power to amend objects: Ordinarily, charities cannot materially depart from their original objects, unless it has become impracticable or impossible to do so, while not-for-profit non-charities are not so constrained. Should there be any limits on ability on charitable or other types of corporations to amend their objects?

10. Audit requirements: Should the size and type of the corporation affect the level of financial review? If so, what different types of financial review should apply to not-for-profit corporations?

11. Level of government supervision and intervention: It has been argued that religious organizations have well-developed internal law, and a fundamental right to be free of government interference or supervision. Should there be different levels of government supervision and intervention for different classes of corporations? Should "outside control" be permitted for religious or any other classes of corporations [2]?

Questions

- Should a classification scheme be developed for the CA?
- If a classification scheme were developed, which classification system would be appropriate for the CA: Saskatchewan *Non-Profit Corporations Act, 1995*; proposed provisions in Bill C-21, *Canada Not-for-profit Corporations Act*; Alberta *Volunteer Incorporations Act* (Bill 54); Ontario Law Reform Commission recommendations; California *Corporations Code* and American Bar Association's Revised Model Act; another model?
- Should organizations be allowed to self-designate their classification?
- In what areas should different classes of corporations be subject to different rules?

[2] Some corporations, particularly religious corporations, may wish to have in place administrative schemes that require directors to seek approval of an outside organization (e.g. a head church) prior to undertaking certain activities ("outside control"). However, "outside control" is inconsistent with the current provisions of the CA, which gives members ultimate control over a corporation. To ensure conformity with the CA, the Ministry of Government Services has had an administrative practice of rejecting applications for letters patent or supplementary letters patent where the constating documents of the organization specifies that an organization may be subject to "outside control" in certain circumstances.

5. Corporate Powers and Capacity

Should corporations incorporated under the Ontario *Corporations Act* be given the capacity, rights, powers, and privileges of a natural person?

Background

General

Under the CA, a corporation, unless otherwise expressly provided in the CA or instrument creating the corporation, has the capacity of a natural person (i.e. the corporation can engage in the same lawful activity as an individual person such as entering into contacts), and may exercise its powers outside of Ontario to the extent permitted by the jurisdiction in which it exercises those powers. [s. 274]

The CA also grants specific powers to not-for-profit corporations. Section 275 grants incidental powers to construct, maintain and alter any buildings or works necessary or convenient for its objects, and to acquire by purchase, lease or otherwise and to hold any land or interest therein. Most of the incidental powers listed in subsection 23(1) in Part II are, by virtue of s. 133, also applicable to not-for-profit corporations governed by Part III.

The CA also allows directors to pass bylaws to regulate various matters relating to members, directors, officers, and "all other particulars of the affairs of the corporation". Bylaws are effective until the next general meeting of members, and will continue to have effect if members at that general meeting confirm them [s. 129]. By contrast, the Saskatchewan *Non-profit Corporations Act* and the Ontario *Business Corporations Act*, specify that it is not necessary to pass bylaws to confer a particular power on a corporation or its directors. Similar provisions were proposed in Bill C-21: *Canada Not-for-profit Corporations Act*.

The Doctrine of *Ultra Vires*

The doctrine of *ultra vires* declares that if a corporation undertakes to do something beyond its power, or what it is entitled to do, then those acts are considered void. This could add potential liability to the directors of the corporation. The *ultra vires* doctrine is an equitable doctrine whose initial purpose appears to have been to permit investors and creditors to exercise some control over the activities of the corporation in which they invested or to which they loaned funds. The doctrine is intended to protect investors and creditors of a corporation by restricting the activities of the corporation and therefore the risks presented by the corporation. However, the doctrine has operated to declare countless valid contracts void, invariably to the detriment of third parties.

Although section 274 of the CA states that a corporation "has the capacity of a natural person", it is believed to preserve the *ultra vires* doctrine to the extent that limitations on the powers of the corporation are expressly set out in the CA or in the corporation's incorporating instrument.

Other Jurisdictions and Models

Ontario *Business Corporations Act* (OBCA)

The OBCA states that a corporation has the capacity and the rights, powers and privileges of a natural person, but prohibits a corporation from carrying on any business or exercising any power that is restricted by its articles. The OBCA explicitly states that no act of the corporation is invalid by reason only that the act is contrary to its articles, by-laws, a unanimous shareholder agreement or the OBCA itself. [ss. 15 and 17] Furthermore, it is not necessary for a bylaw to be passed in order to confer any particular power on the corporation or its directors. [s. 17(1)] Like the current CA provision, an OBCA corporation has the capacity to carry on its business, conduct its affairs and exercise its powers in any jurisdiction outside Ontario to the extent that the laws of such jurisdiction permit. [s. 16]

In effect, under the OBCA, acts that are in excess of the powers and capacities of the corporation under its articles and constituting statute will not be sanctioned with a nullity, even if all parties to the transaction knew that the transaction was in violation of the statute. However, such contracts would still be illegal and subject to the sanctions generally available at common law for illegal contracts.

The Saskatchewan *Non-profit Corporations Act* and Bill C-21: *Canada Not-for-profit Corporations Act* contain provisions regarding corporate powers and capacity that are similar to the OBCA provisions.

U.S. Revised Model Nonprofit Corporation Act (1987)

Under the U.S. Model Act, unless a corporation's articles provide otherwise, it will have the same powers as an individual to do all things necessary or convenient to carry out its affairs. [s. 3.02] The doctrine of *ultra vires* is abrogated in most circumstances, but is preserved for proceedings against the corporation when a third party has not acquired rights, and for proceedings against an incumbent or former director, officer, employee, or agent. [s. 3.04]

Questions

- Should not-for-profit corporations be given the capacity, rights, powers and privileges of natural persons? If so, should the articles of 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 CA is not changed to provide corporations with the powers of natural persons, should the CA specify that passage of by-laws continue to be required in order to confer powers on corporations or its directors?
- Should the CA adopt provisions similar to the Ontario *Business Corporations Act*, the U.S. Revised Model Nonprofit Corporation Act (1987), or another model to govern the capacity and powers of a not-for-profit corporation?

6. Other Issues

This paper focuses on the broad issues concerning the CA. Subsequent discussion papers will be released to the public in the future to generate feedback on more specific items in the areas of directors' and officers' issues, membership issues, corporate finances, fundamental changes and dissolution. The Ministry of Government Services would like to take this opportunity to generate some preliminary feedback on areas of special interest, including directors' and officers' liability, financial disclosure, and members' remedies.

6.1 Directors' and Officers' Liability

Background

Currently, the CA lacks provisions that set out the duty of care, standard of care, and defences against liability applicable to directors and officers. Directors may be personally liable to account for losses from breach of their fiduciary duties, conflict of interest, fraud, negligence, or criminal behavior. Directors may also be personally liable for unpaid wages, taxes, and pension contributions owing by a corporation when the corporation becomes insolvent.

Several considerations should be taken into account when considering the issue of liability for directors and officers of not-for-profit corporations. The not-for-profit sector is concerned with difficulties in recruiting and retaining qualified directors and officers in the face of the increasing potential for liability due to the wide range of activities in which not-for-profits are now engaged. It has also been suggested that there is an inherent unfairness in finding a person or organization who performs valuable public services as a volunteer to be liable. A reasonable liability regime for directors and officers must take into account the need for directors and officers to be treated fairly and the need for accountability to those who suffer losses from breaches of duties by directors, officers and/or their not-for-profit corporations.

Questions

- 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 CA? 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 not-for-profit 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?

6.2 Financial Disclosure

Background

Financial information disclosure is an essential part of ascertaining and ensuring the accountability of not-for-profit corporations. The CA requires that a not-for-profit corporation keep proper books of account and accounting records with respect to all financial and other transactions. [s. 302] Accounting and other records are to be kept at the head office of the corporation and open for inspection by any director during normal business hours of the corporation. [s. 304] Directors must present before each annual meeting of the members a copy of the corporation's financial statements, and if not exempt from an audit[3], an auditor's report in which the auditor provides an opinion about whether or not the financial statements present fairly the financial position of the company and the results of its operations in accordance with generally accepted accounting principles. [s. 97] The CA does not require any particular form of public financial disclosure by not-for-profit corporations, nor does it provide access to the books of account to members of the organization. However, the Canada Revenue Agency imposes reporting requirements, relating to receipts and donations, on charities and large non-charitable not-for-profit organizations.

Questions

- 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; another level of disclosure?
- Should the level of financial disclosure required vary based on classification and/or type, or size of organization?

6.3 Members' Remedies

Background

The CA sets out procedures for aggrieved members of not-for-profit corporations with respect to a failure by the corporation or its director, officer or employee to perform any duty imposed by the CA. If the corporation or its director, officer or employee fails to perform the duties imposed by the CA, members can apply to court for a compliance order directing the performance of those duties. [s. 332]

Other members' remedies provided by the CA are as follows:

- If requested by at least one-tenth of members, a general membership meeting can be held for any purpose connected to the corporation. [s. 295]
- If a person's name is improperly entered or omitted from minutes or registers, an application may be made to court for that error or omission to be rectified. [s. 309]

[3] Not-for-profit corporations incorporated under the Ontario *Corporations Act* are subject to annual audit requirements unless they qualify for an exemption under section 96.1. The audit exemption requirements under section 96.1 were recently amended by Bill 152, *Ministry of Government Services Consumer Protection and Service Modernization Act, 2006*, which received Royal Asset on December 20, 2006, and will come into force on August 1, 2007.

- Upon application by at least one-tenth of members, the court may appoint an inspector to investigate the affairs and management of the corporation or audit its books. [s. 310]
- Members can also replace the directors of the corporation as they see fit.

There are currently no provisions in the CA that allow members to obtain an oppression remedy, derivative action, right to dissent and appraisal, or provisions for fair hearing and natural justice.

Questions

- What types of remedies should members be entitled to under the CA?
- Should the criteria for obtaining a compliance order under the CA be broadened to require compliance with respect to the failure of directors to perform duties in addition to those set out in the CA, such as duties imposed by bylaws?
- Should the oppression remedy be included in the CA?
- Should the derivative action be included in the CA?
- Should a right to dissent and the appraisal with respect to members' fees be available under the CA?
- Should a right to require mediation or binding arbitration be included in the CA, and if so, in what circumstances?
- Should provisions be included in the CA that provide for a fair hearing and natural justice where a corporation takes disciplinary action against a member?

Please provide the Ministry of Government Services with your recommendation(s) and the rationale for your recommendations with respect to the above-mentioned issues.

This is a public review.

All materials or comments received from organizations may be used and disclosed by the Ministry to assist in evaluating and revising existing legislation and related regulations. This may involve disclosing materials, comments, or summaries of them, to other interested parties during and after the public comment period.

An individual who provides materials or comments and who indicates an affiliation with an organization will be considered to have submitted those comments or materials on behalf of the organization so identified.

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