

Ontario Ministry of Government and Consumer Services

Reform of the Ontario *Corporations Act*

**SUPPLEMENTARY MATERIALS to
May 7, 2007 CONSULTATION PAPER:
*Modernization of the Legal Framework Governing
Ontario Not-for-Profit Corporations***

Introduction

On May 7, 2007, the Ministry of Government and Consumer Services released its first consultation paper on the *Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations*. The information contained herein is intended to supplement the contents of the paper and provide some possible options for dealing with each of the main issues raised in the paper. For each of the options, some pros and cons have been included to assist in the analysis of each option.

The options presented in this paper are for discussion purposes only and are not exhaustive of the options available to address each issue. Similarly, the pros and cons for each option do not represent a complete list. The Ministry welcomes your suggestions on any additional options that would best suit the needs of this reform project.

The discussion of the issues that is provided in these materials is intended to assist in understanding the options that are presented. Additional background information is contained in the consultation paper. For ease of reference, the issues are presented here in the same order and numbering system used in the consultation paper. Statutory references in brackets are to the *Corporations Act*.

1. Incorporation Process

Should the reformed Act move to a system of incorporation “as of right”?

Options

A) Retain current discretionary letters patent system (comprehensive review of name, purposes, and special provisions).

Under the current system, nonprofit organizations seeking incorporation under the Ontario *Corporations Act* (CA) are required to file an application for letters patent together with supporting documents and payment of the required fees.

Incorporation documents are reviewed by Ministry staff to determine if they are in accordance with Ministry policies. Content is checked and suggestions are made for revisions when deemed necessary (e.g., where listed purposes are too vague, names do not appear to reflect purposes, purposes are commercial in nature, etc.).

Although technically incorporation is completely discretionary, in practice it is normally granted as long as the application is in accordance with the Ministry’s policies made under the authority of the statute.

Pros	Cons
i. Ensures that approved letters patent are reviewed for compliance with the statute, reducing the likelihood that further amendments will be needed	i. Delays and significant backlogs can occur because of the time required to review and amend those applications that are found to be deficient.
ii. Increases the likelihood that the incorporating documents will be correct.	ii. Although electronic incorporation may be possible under this option, in most cases it would only occur following significant delays.

B) Provide for incorporation “as of right” with government review of the proposed name only.

Under this option, applications for incorporation would be automatically approved as long as they meet a limited checklist of requirements for incorporation. This checklist could be similar to the one currently used for business corporations under the Ontario *Business Corporations Act* where Ministry staff ensures that the necessary fields are completed, the application is legible, duplicate copies are signed, the prescribed fee is enclosed, etc.

There would be no government review of items not on the checklist. Instead, it would be the responsibility of incorporators to ensure that their incorporating documents are prepared in compliance with all the requirements of the statute and regulations. This means that incorporating documents will be accepted by the government even though they contain errors.

Proposed corporate names would still be reviewed. The purpose of reviewing names includes avoiding confusion caused by similarities between the names of two or more corporations and checking for compliance with regulatory requirements.

This option would not affect the requirements currently imposed by the Office of the Public Guardian and Trustee (OPGT) in respect of incorporating charitable organizations as these are requirements imposed separately by the Ministry of the Attorney General. That is, charitable corporations would still be required to either use pre-approved purposes and special provisions or seek the approval of the OPGT to incorporate.

Pros	Cons
i. Allows for a more expeditious processing of applications for incorporation.	i. The government would not review applications for incorporation except for a limited checklist, which would likely result in a higher error rate. These errors may result in the need for the corporation to file amending documents with the Ministry, or they may result in complaints against the corporation to the Ministry.
ii. Electronic incorporation may be feasible, but it would not provide for immediate incorporation due to time required to approve the corporate name.	ii. Places a greater burden on incorporators to conduct a review of items not checked by the Ministry; there is a risk that incorporation documents may not be filed properly.
iii. Applicants have assurance that incorporation will occur if they meet certain requirements, regardless of other errors.	iv. Approved incorporation documents may contain provisions that are contrary to the statute, e.g., suggesting that a corporation has authority to regulate an industry, which may create confusion of the public.
	v. If documents are not filed properly, there is potential liability for directors.
	vi. Risk of for profit businesses incorporating as nonprofit corporations if there is no review of purposes.

C) Partial “as of right” incorporation (review of proposed name and a limited review of purposes and special provisions).

This option is the middle-ground between options A and B. Under this incorporation system, review of applications would be limited to a checklist of items that would be less comprehensive than the current review of letters patent. For example, review may be limited to ensuring that the primary purpose of incorporation is not commercial and that the applicants do not provide themselves with regulatory powers. The review would not check any items not on the checklist, for example whether the purposes are too vague, or whether certain necessary consents are provided. A review of the intended name would still take place as with the other two options.

Pros	Cons
i. Allows for a more expeditious processing of applications for incorporation than the current system.	i. Some delay may occur due to the time required to carry out the limited review (although it may be faster than the current system).
ii. Electronic incorporation may be feasible (but incorporation may not be as fast as under option B due to the time required to carry out the limited review).	ii. Documents may still be returned for revision before incorporation is permitted, but this is not likely to be as frequent as under the current system.
iii. Applicants have assurance that incorporation will occur if they meet the requirements on the checklist.	iii. Documents returned for revision may still contain errors once approved because the government’s review would be limited to items on the checklist.

D) Incorporation “as of right” with review of proposed names for applications using pre-approved provisions; all other applications would receive the existing discretionary letters patent system review.

Under this option, the government would provide incorporators with a list of pre-approved purposes and special provisions. Applications for incorporation that use pre-approved provisions would be subject to the “as of right” system with review of the proposed name only. Incorporators who wish to draft their own purposes and special provisions would still be free to do so and their applications would be reviewed by the Ministry under the current system (this is the same approach that is currently used with charitable corporations). A variation on this approach could involve requiring just one broad statement of purpose rather than permitting multiple nonprofit purposes in the incorporating documents. These broad statements would also be chosen from a pre-approved list.

Pros	Cons
i. Provides a faster option for incorporators who use pre-approved objects.	i. Because of the breadth of activity of the nonprofit sector, it will not be possible to capture every type of nonprofit activity in the list of proposed purposes and an organization may not be able to fit under one of the listed purposes. Such corporations would default back to the government review system.
ii. Applications that do not use the pre-approved list will be subject to government review which will reduce the risk of error and the need for future amendments.	ii. Delay may still occur in the case of applications that do not use the pre-approved lists.
iii. List of proposed purposes and special provisions would be flexible and would be regularly monitored and updated by the Ministry to accommodate the changing needs of nonprofits over time.	iii. If the variation of requiring one broad statement is chosen, it may not provide for sufficient detail as to the activities of the corporation.
iv. Electronic incorporation may be feasible allowing incorporators to choose pre-approved provisions from a drop-down list (however incorporation would not be immediate due to the time required to approve the proposed name).	
v. Applicants have assurance that incorporation will occur if they use pre-approved provisions and the proposed name is approved.	
vi. Of convenience to incorporators who do not have the resources necessary to develop purposes and special provisions.	
vii. If the variation of requiring one broad statement is chosen, it would be simpler to incorporate and to use the pre-approved list.	

2. Structure of the reformed nonprofit Corporations Act

What structure should the reformed Act follow?

Options

A) Follow the structure of the Ontario *Business Corporations Act* (OBCA).

The OBCA is structured with the whole Act applying to every type of business corporation with exceptions and limitations set out in specific sections. The OBCA is set out in a logical fashion, beginning with incorporation and moving through topics including corporate finance, membership, directors and officers, fundamental changes, etc.

Pros	Cons
i. This structure is clear and easy to follow.	i. May not easily accommodate different classes of corporations (if a class system is adopted).
ii. There is familiarity with the structure.	

B) Follow the structure of the California *Corporations Code*.

This California *Corporations Code* is divided into a general part that applies to all nonprofit corporations incorporated under it, and specific parts for designated types of nonprofit corporations.

Pros	Cons
i. This structure would be easy to navigate if a class system is adopted since specific provisions applicable to each class would be grouped together.	i. Statutory provisions would be lengthier and more complex than with option A.
	ii. If a class system is not established in the reformed Act, this structure may not be suitable.

Stakeholders may find that modifications to the above structures, or a different structure all together, is the preferred option for the reformed Act. The Ministry welcomes stakeholder input on any additional legislative structures or modifications to existing structures.

3. Definition of Not-for-Profit Corporation

3.1.1 Clarification of Purpose

Should the reformed Act contain a list of permitted purposes?

Options

A) Continue with status quo (all purposes permitted within jurisdiction of province of Ontario, with limited exceptions).

Currently, the CA states that a nonprofit organization can be incorporated with any “objects that are within the jurisdiction of the province of Ontario” [s.118]. The only restriction on this statement contained in the CA is that a nonprofit corporation “shall be carried on without the purpose of gain for its members and any profits or other accretions to the corporation shall be used in promoting its objects” [s.126(1)]. Given the breadth of section 118, Ministry policy has been to require purposes (objects) to be nonprofit.

The current wording of section 118 was introduced in 1994 and replaced a list of categories of permitted purposes.

The exceptions to incorporation are nonprofits that are railway corporations and corporations under the *Loan and Trust Companies Act* [s.4(1)].

Pros	Cons
i. Existing provision accommodates a wide variety of nonprofit purposes with no risk of excluding legitimate nonprofit purposes.	i. If incorporation as of right is chosen, the status quo could result in for profit businesses incorporating as nonprofit corporations because there would be no government review.
	ii. May be too vague; does not give sufficient guidance to incorporators as to which purposes would qualify for incorporation and which purposes would not.

B) Clarify the existing wording without listing categories of permitted purposes.

Under this option, the reformed Act would clarify that nonprofit corporations can be incorporated for any purposes permitted under Ontario law provided that the purpose is nonprofit. In effect, this option would codify the Ministry’s current policy of requiring purposes to be nonprofit.

Pros	Cons
i. Accommodates a wide variety of nonprofit purposes with no risk of excluding legitimate nonprofit purposes.	i. If incorporation as of right is chosen, the status quo could result in for profit businesses incorporating as nonprofit corporations because there would be no government review. ii. Does not give guidance to incorporators as to what are genuine nonprofit purposes (may be difficult to define “nonprofit”).
ii. Provides slightly more guidance than option A on the permitted purposes of incorporation.	
iii. Codifies the Ministry’s existing practice of requiring purposes to be nonprofit.	
iv. Clarifies that any proposed purposes involving gain, or profit, are not acceptable.	

C1) List specific categories of permitted purposes.

With this option, a comprehensive list of purposes would be provided under which a nonprofit could apply for incorporation.

Pros	Cons
i. Could help to preclude businesses from incorporating as nonprofit corporations.	i. There is a risk that certain organizations with nonprofit purposes could be excluded from incorporation. (This approach was used in the past prior to the 1994 legislative amendment and proved difficult for incorporators whose purposes were nonprofit but did not fit into a specific category.)

C2) If classes of nonprofit corporations are provided for in the reformed Act, permitted categories of purposes could be provided for each class.

Similar to option C1, with this option a comprehensive list of purposes would be provided. However, in this case the statute would contain multiple lists of purposes since a specific list would be provided for each designated class. Most likely the lists would differ from one another depending on the specifics of a given class.

Pros	Cons
i. Gives guidance to incorporators as to appropriate purposes for a particular type of corporation.	i. There is a risk that certain nonprofit organizations with nonprofit purposes would be excluded from incorporation.
ii. Facilitates incorporation for	ii. This approach is complex which

purposes that are genuinely nonprofit.	may make it difficult for incorporators to understand.
iii. Precludes businesses from incorporating as nonprofit corporations.	

D) List excluded purposes only.

Nonprofit corporations would be entitled to incorporate for any purpose provided it is not listed specifically as forbidden in the statute.

Pros	Cons
i. No risk of excluding legitimate nonprofit purposes.	i. Does not give guidance to incorporators as to what are genuine nonprofit purposes.
	ii. There is a risk of allowing nonprofit corporations conducting illegitimate activities to incorporate if not caught by the list of exclusions.
	iii. May be potentially very confusing and difficult to determine whether some purposes fail the test.

3.1.2 For-Profit Activities

Should there be any restrictions on the commercial activities of nonprofit corporations?

The CA does not explicitly state whether nonprofit corporations are permitted to engage in incidental for-profit/commercial activities. Section 126 states that any profits or accretions to the corporation must be used in promoting the corporation's objects and that this must be stated in the application for incorporation.

The CA has generally been applied to mean that nonprofit corporations may engage in for-profit activities that are ancillary to their primary nonprofit purposes, in order to further these nonprofit purposes.

Options

A) No restriction on commercial activity in furtherance of nonprofit purposes.

With this option, there would be no restriction on commercial activity, although nonprofit corporations would not be permitted to have business purposes as their primary goals. Nonprofits would be permitted to engage in commercial activities in order to advance, or support, their nonprofit purposes.

Pros	Cons
i. Enables nonprofits to raise sufficient funds to achieve their nonprofit purposes.	i. In the event that a commercial activity fails, it could result in losses to the corporation that can affect its nonprofit activities.
ii. Reduces need to rely on other sources of funding, including government and private donations.	

B) Some restriction on commercial activity.

With this option, the type and extent of restriction would need to be determined.

Pros	Cons
i. May help to prevent a situation whereby a failing commercial activity results in a negative impact on the corporation's nonprofit activities.	i. May make it more difficult for nonprofits to raise sufficient funds to achieve their nonprofit purposes.
	ii. Creates increased reliance on other sources of funding, such as government and private donations.
	iii. Could result in the dissolution of nonprofit corporations that can no longer sustain themselves.

3.2 Non-Distribution Constraint

Subsection 126(1) of the CA requires that a nonprofit corporation be carried on “without the purpose of gain for its members.” This is known as the non-distribution constraint. The wording used in the subsection has created considerable uncertainty around the scope of permitted distributions. Is the provision meant to exclude gains in any form or is it meant to preclude only the distribution of profits to members through dividends or some other form of direct distribution? The language of the section does not offer any guidance on this question. Furthermore, should the determination of permitted distributions vary depending on whether the distribution occurs during the life of the corporation or following dissolution?

I. What prohibitions should apply to the distribution of profits or increases in property values to directors, officers and members during the lifetime of a corporation?

Options

A) Prohibit distributions, without any exceptions.

Pros	Cons
i. Rule is clear and consistent with the concept of a nonprofit corporation.	i. May be too restrictive and may cause hardship if no exceptions are provided for in certain cases (for example, when out of pocket expenses are incurred by the director/officer/member).

B) Prohibit distributions, with some exceptions.

Examples of possible exceptions are indemnification, remuneration for services provided, reimbursement for out-of-pocket expenses, etc.

Pros	Cons
i. Rule is clear and consistent with the concept of a nonprofit corporation.	i. It may be difficult to precisely define all required exceptions.
ii. Provides for necessary flexibility to cover cases such as indemnification, remuneration for services, and reimbursement for expenses.	

II. Upon dissolution, what limitations, if any, should be placed on the distribution of corporate property?

Options

A) Maintain status quo (distribution to members unless by-laws provide otherwise).

Section 132 of the CA provides that the corporation's by-laws can specify that, upon dissolution and after payment of all of the corporation's debts and liabilities, remaining property can be distributed to the provincial or federal governments, municipal corporations, charitable organizations, or organizations whose purposes are beneficial to the community. Where no such by-law exists, the section specifies that the property shall be distributed equally among all members.

In the case of charitable corporations, the OPGT requires, as a condition of consent to incorporation, that the incorporating documents specify that remaining assets be distributed to other charitable corporations upon dissolution. Other corporations that are not charitable are not captured by this rule.

Pros	Cons
i. No significant concerns have been raised regarding the current provision (but this may be because of the OPGT's practice in respect of charitable corporations).	i. As a matter of public policy, it is not appropriate for public benefit organizations, including those that solicit public donations, to distribute remaining property to members.
	ii. Funds donated by the public may be used for purposes that were not intended by the donors.
	iii. Statute does not reflect the existing policy of the OPGT.

B) In the case of charitable and other public benefit corporations, including those that solicit funds from the public, require distribution to charitable or other public benefit corporations as determined by the members. All other corporations could distribute to members in the absence of a provision to the contrary in the incorporating documents or by-laws.

Pros	Cons
i. Gives members flexibility in determining which organizations should receive remaining corporate property.	i. It is difficult to identify and define all public benefit corporations and some corporations may have both private and public purposes. (For example, would a corporation established for the benefit of its members but that solicits funds from the public be considered a public benefit corporation? Similarly, how ought a

	corporation that is 10% for the public benefit but 90% for private benefit to be treated? Furthermore, should corporations that are in the public benefit but that do not solicit funds from the public be subject to the same requirements?).
ii. Codifies longstanding practice (as implemented by the OPGT) for charitable corporations and extends it to public benefit corporations.	ii. Funds donated by the public may be used for purposes that were not specifically intended by the donors (although they would go towards other public benefit or charitable purposes).
iii. In the case of charitable corporations and other public benefit corporations, including those that solicit funds from the public, ensures that funds donated by the public are used for the original or similar purposes.	

C) For all nonprofit corporations, require that distributions be made to corporations with similar purposes.

This option would expand the requirement imposed by the OPGT on charitable corporations to all nonprofit corporations.

Pros	Cons
i. Ensures that any donations are used for the purposes for which they were intended.	i. May be some disagreement over which purposes are similar.
ii. Is not offensive to public policy; ensures that the remaining property is used to further nonprofit purposes.	ii. In the case of very specialized purposes, it may be difficult to find another corporation with similar purposes.
iii. Overcomes problem in option B of having to determine which corporations are of public benefit .	iii. May be unfair to private member corporations that do not have any public purposes.

4. Classification System

Should a classification system that provides for multiple classes of nonprofit corporations be included in the reformed Act?

Currently, there is no classification system under the CA. There is only one type of nonprofit corporation, that being a corporation whose purposes are within the jurisdiction of the province of Ontario [s.118].

As a matter of policy, there is a different set of rules and a separate application process for charitable corporations. These are a special type of nonprofit corporation and the policy and practice of the current government requires such applications to use pre-approved purposes and special provisions, or obtain prior approval from the OPGT.

Options

A) Maintain the status quo (no classification system, except for the different set of rules and processes for charitable corporations that are applied as a matter of policy).

Pros	Cons
i. Avoids the challenges of segmenting the sector into classes.	i. May not address specific needs of certain types of nonprofit corporations.
ii. Avoids misclassification.	
iii. Enables new statute to be simpler.	

B) Include a classification system that provides for multiple classes of corporations.

Pros	Cons
i. May meet the needs of certain nonprofits more adequately by allowing for specific provisions applicable to each class.	i. In some circumstances, it may be difficult to determine under which class to incorporate and there is a risk of misclassification.
	ii. It may be difficult to determine how classes should be treated differently from one another.
	iii. There are multiple ways to segment the nonprofit sector; determining the optimum list of classes is not straightforward.
	iv. May significantly increase the complexity of the reformed Act.

5. Corporate Powers and Capacity

I. Should nonprofit corporations be given the capacity, rights, powers, and privileges of a natural person?

Options

A) Maintain status quo (allow for restrictions on powers in either the CA or the incorporating documents and include list of permitted powers in the Act).

Currently, section 274 of the CA provides that a nonprofit corporation has the capacity of a natural person. However, the same provision also says that this capacity is limited through expressions to the contrary either in the CA itself or in the incorporating documents. There is considerable legal uncertainty concerning the extent of powers available to a nonprofit corporation under section 274 in the face of other provisions in the CA that specifically set out certain permitted powers. This uncertainty has led nonprofit corporations to develop a practice of supplementing the list of permitted purposes in their letters patent to ensure that the corporation has all of the necessary powers to carry out its purposes.

Pros	Cons
No apparent pros as compared with option B.	i. Current provisions are confusing and difficult to understand causing legal uncertainty.
	ii. Unsophisticated parties may have inadequate powers because they did not know to provide for supplementary powers in the letters patent or did not do so adequately.
	iii. A corporation may have insufficient powers to carry out its purposes.

B) Provide nonprofit corporations with all the powers of a natural person, with any restrictions to be set out only in the incorporating documents.

This option would include the elimination of provisions that set out permitted powers as these become redundant if the corporation has all the powers of a natural person.

Pros	Cons
i. Ensures corporations have all the necessary powers to fulfil their purposes.	No apparent cons as compared with option A.
ii. Eliminates the risk of liability arising from inability to carry out certain activities due to insufficient powers.	
iii. Ensures legal certainty.	

II. Should the *ultra-vires* doctrine be abolished?

Under the common law, the *ultra-vires* doctrine provides that where a corporation acts outside its powers or purposes, the acts are invalid. This doctrine continues to be applicable today.

Options

A) Preserve *ultra-vires*.

Pros	Cons
i. Ensures that the corporation acts only within its authority.	i. May adversely impact innocent third parties who enter into contracts with the corporation without the knowledge that the corporation is acting outside its authority.
	ii. Creates significant potential liability for volunteer directors.

B) Abolish *ultra-vires* (through a specific provision to that effect in the reformed Act) but provide for member remedies in a case where a corporation acts beyond its permitted purposes.

Pros	Cons
i. No adverse impact on innocent third parties.	i. Where the corporation has restrictions on its powers that are set out in the incorporating documents, the <i>ultra-vires</i> doctrine is not available to nullify acts that contravene those restrictions (although it is always open for a court to declare such actions illegal or void on other grounds).
ii. Reduces potential liability for directors thereby encouraging volunteers to serve on boards.	
iii. Provides appropriate member remedies where a corporation acts beyond its permitted purposes.	