

## **NON-SHARE CAPITAL CORPORATIONS MUST STRICTLY ADHERE TO CORPORATE GOVERNANCE PROCEDURES**

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### **A. INTRODUCTION**

This *Charity Law Bulletin* ("Bulletin") examines *Rexdale Singh Sabha Religious Centre v. Chattha*<sup>1</sup>, a recent Ontario Superior Court of Justice decision which involved a dispute over the corporate governance procedures of three inter-related non-share capital corporations. The dispute was particularly rooted in the decision-making and management of the corporations, including the process for adding new directors, issues concerning membership, and the failure to pass by-laws.

Despite its brevity, this ruling manages to cover a wide range of significant issues in connection with non-share capital corporations and demonstrates that such entities must adhere as strictly to corporate governance procedures as their share capital counterparts.

### **B. BACKGROUND**

The Rexdale Singh Sabha Religious Centre ("Rexdale") was incorporated by letters patent by five directors in 1993 to serve as a Sikh temple and was registered as a charitable organization. The five directors were Amarjit S. Deol ("Deol"), Narinder Singh ("Singh"), Ranjit S. Hans ("Hans"), Harlaikjinder Chattha ("Chatta") and Surgit S. Gill ("Gill").

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<sup>1</sup> [2006] O.J. No. 328.

Three of the five directors, Chattha, Gill and Hans, the Respondents/Applicants by cross-application (the “Respondents”), stopped participating as directors in 1997 or 1998 without resigning, either due to lack of time or because the remaining directors did not keep them apprised of the meeting dates for the board of directors.

Prior to the incorporation by letters patent of the related Sikh Spiritual Centre (“Spiritual Centre”) in 2001 as a successor temple to Rexdale, and of the Akal Funeral Home (“Akal”) in 2002 as a not-for-profit organization, the two directors who continued to participate, Singh and Deol, unilaterally increased the number of directors of Rexdale from five to fifteen, without conducting an election by the members of Rexdale as required by the *Corporations Act* (Ontario)<sup>2</sup>, the legislation under which Rexdale had been incorporated.

As the construction of Akal was nearing completion, a dispute arose between the ten individuals holding themselves out as the new directors on one side, and Singh, Chattha, Gill and Hans on the other. It was unclear about who could be directly involved with the completion of the Akal Funeral Home and who could continue its operation upon completion. The new directors prevented four of the original directors from accessing both Akal and the accounting records and cheques for Rexdale, which exclusionary measures led to the Court’s involvement.

According to Singh, the majority of the congregants of the two temples also appeared to be unaware that there were three separate corporate entities. Most believed that their charitable donations were going toward the purchase and development of all three properties as a single entity.

Singh and Deol took it upon themselves to begin the creation of a membership list for both Rexdale and the Spiritual Centre by approaching those who had made donations toward the purchase and building of the temples. In exchange for a \$5.00 fee, these people received a membership card and number. Yet, there were no by-laws governing their membership, no members’ meetings held, and no members’ vote on any matters, including the election of the ten new directors.

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<sup>2</sup> R.S.O. 1990, c. C.38.

### C. THE APPLICANTS' SUBMISSION

Rexdale and Akal, the Applicants/Respondents by cross-application (the "Applicants"), sought a court order declaring:

- ♦ "that the members and directors of Akal Funeral Home and Sikh Spiritual Centre are comprised of the applicants for the letters patent; and
- ♦ that the members and directors of Rexdale Singh Sabha Religious Centre are comprised of the applicants for the letters patent along with a list of people purported to have been appointed by the Special Resolution executed by Narinder Singh on January 14, 2001."<sup>3</sup>

The Applicants sought to recognize the appointment of the ten new directors, proposing that the "manner in which it was done was only an irregularity,"<sup>4</sup> which the Court could remedy. They further submitted that "non-profit organizations should not be required to adhere rigorously to the technical requirements of corporate procedure as long as their basic process is fair."<sup>5</sup> The Applicants also suggested that the directors had been appointed in a fashion that was in "the best interests of the corporation"<sup>6</sup> because they were sharing in the heavy workload generated by cost overruns and demands for accounting in connection with the construction of the funeral home.

### D. THE RESPONDENTS' SUBMISSION

By contrast, the Respondents sought a court order:

- ♦ fixing the membership of each of the three corporations as set out in an exhibit to the affidavit of Narinder Singh; and
- ♦ "an order declaring that the meetings of the membership of each of Rexdale, Spiritual Centre, and Akal be called by the Directors listed on each of these corporations' letters patent, within thirty days, for the purposes of fixing the number of Directors of the relevant corporation and of electing such Directors by means of a fair vote."<sup>7</sup>

The Respondents also cited a number of examples of non-compliance with the law governing Ontario not-for-profit corporations, including the following:

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<sup>3</sup> *Supra* note 1 at par. 1.

<sup>4</sup> *Ibid.* at par. 10.

<sup>5</sup> *Ibid.* at par. 11.

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.* at par. 2.

- ♦ None of the three corporations had ever held a members' meeting, not even to elect the Board of Directors;
- ♦ None of the original five Directors of the corporations had ever formally resigned, so they all remained in office;
- ♦ The number of Directors was not legally changed from five (as set out in the letters patent) to fifteen;
- ♦ No by-laws had ever been passed by the members or the Directors of the corporations;
- ♦ Akal was not operating properly as a corporation because its Board of Directors had never met.

The Respondents also pointed out that, not only were there no by-laws governing membership, the letters patent were silent on the issue of membership. Yet, there were congregants of the corporations who regularly worshipped at the temples, gave financial contributions and were given membership cards and numbers. It was the position of the Respondents that these congregants were, in fact, the actual "members" of the three corporations.<sup>8</sup>

## E. THE LAW

The Court reviewed several relevant provisions in the *Corporations Act* (Ontario):

- ♦ Section 248(1) – First Directors – The persons named as first Directors in the Act or instrument creating the corporation are the Directors of the corporation until replaced by the same number of others duly elected or appointed in their stead.
- ♦ Section 287(1) – Election of Directors – The Directors shall be elected by the shareholders or members in general meeting and the election shall be by ballot or in such other manner as the by-laws of the corporation prescribe.
- ♦ Section 93(1)(a) – Shareholders' Meetings – Notice of the time and place for holding a meeting of the shareholders [or members of a non-share capital corporation] shall ... be given ... ten days' [written notice].

## F. THE COURT'S DECISION

The Respondents were granted the relief sought concerning membership, fixing the number of directors and the future election of directors by the members by means of a fair vote.

The Court invalidated the appointment of the ten new directors because the process used was in

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<sup>8</sup> *Ibid.* at par. 16.

contravention of the provisions of the *Corporations Act* (Ontario), even if the appointments had otherwise been in the best interests of the corporation.

The Court acknowledged that the directors had not called any members' meetings and had not properly passed any by-laws, but agreed that the congregants required protection. Thus, the Court approved the membership list as set out in an exhibit to Narinder Singh's affidavit because at least four of the five directors had approved the list. In this regard, the Court was exercising "its remedial power to make such an order as was just."<sup>9</sup>

## G. COMMENTARY

*Rexdale Singh Sabha Religious Centre v. Chattha*<sup>10</sup> is an important decision for charities and not-for-profit organizations because it evidences how vital a clear decision-making and governance process is for non-share capital corporations. Issues concerning by-laws, membership, frequency of meetings, notice of meetings and the election of directors are all significant aspects in the day-to-day life of charitable and not-for-profit corporations. In particular, this decision demonstrates that a corporation's first directors must clearly define the corporation's by-laws from the outset and then comply thereafter with the applicable enabling legislation.

In addition, the following comments provide an overview of additional statutory provisions for non-share capital corporations, which were either referred to directly in the Court's decision, or are relevant by analogy.

### 1. Notice of Members' Meetings

In determining which provisions of the *Corporations Act* (Ontario) apply to non-share capital corporations, it is imperative that subsection 133(1) be carefully reviewed. This section identifies which provisions of Part II apply to Part III non-share capital corporations. In the Court's analysis, it was correct in stating that section 93 (shareholders' meetings) applied to Rexdale and Akal, both non-share capital corporations. Rexdale was also a registered charitable corporation, while Akal's status was that of a not-for-profit funeral home.

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<sup>9</sup> *Ibid.* at par. 20. See also *Burlington Association for the Mentally Retarded (Re)*, [1981] O.J. No. 289 (H.C.) and *Sobrinho v. Oakville Portuguese Canadian Club* (1982), 37 O.R. (2d) 581 (H.C.).

<sup>10</sup> *Supra* note 1.

However, had Rexdale, as a registered charitable corporation, been the only Applicant, the Court could have applied subsection 133(2), which deals with alternative notice procedures for a members' meeting. Specifically, subsection 133(2) provides as follows:

“Despite subsection (1), in the case of a corporation to which this Part applies, *the objects of which are exclusively for charitable purposes*, it is sufficient notice of any meeting of the members of the corporation if notice is given by publication at least once a week for two consecutive weeks next preceding the meeting in a newspaper or newspapers circulated in the municipality or municipalities in which the majority of the members of the corporation reside as shown by their addresses on the books of the corporation” [emphasis added].

## 2. By-laws

The Court in *Rexdale Singh Sabha Religious Centre v. Chattha* acknowledged that the original directors had not properly passed any by-laws for the proper governance of the corporations. However, the decision does not make reference to the statutory provisions regarding what is required. In this regard, general operating by-laws are a vital aspect of any corporation, since they specify “the everyday rules of management governing the operation of a corporation. In practical terms, by-laws effectively create a contractual relationship among the members and directors *vis-à-vis* the internal regulation of the corporation.”<sup>11</sup>

As was the situation among Rexdale, Spiritual Centre and Akal, “the complete absence of by-laws or inadequate by-laws can inevitably cause serious problems in any corporation. Proper drafting of the by-law is essential since it establishes the ground rules early and provides guidance to the board of directors in their management of the affairs of the corporation.”<sup>12</sup>

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<sup>11</sup> Burke-Robertson, Jane and Arthur C. Drache. *Non-Share Capital Corporations* (Toronto: Thomson Carswell, 2002) 3-1.

<sup>12</sup> *Ibid.* at 3-1 to 3-2.

### ***Corporations Act (Ontario)***

In Ontario, the *Corporations Act* has “an extensive list of matters that may be the subject of by-laws. This list is more detailed than the federal provision [under the *Canada Corporations Act*], but at the same time the items contained therein are merely suggestions and are not required to be dealt with as in the federal jurisdiction. The items which may be dealt with under section 129 are:”<sup>13</sup>

- a) the admission of persons and unincorporated associations as members and as [*ex officio*] members, and the qualification of and the conditions of membership;
- b) the fees and dues of members;
- c) the issue of membership cards and certificates;
- d) the suspension and termination of memberships by the corporation and by the member;
- e) the transfer of memberships;
- f) the qualification of and the remuneration of the directors and the [*ex officio*] directors, if any;
- g) the time for and the manner of election of directors;
- h) the appointment, remuneration, functions, duties and removal of agents, officers and employees of the corporation and the security, if any, to be given by them to it;
- i) the time and place and the notice to be given for the holding of meetings of the members and the board of directors, the quorum at meetings of members, the requirements as to proxies, and the procedure in all things at members’ meetings and at meetings of the board of directors; and
- j) the conduct in all other particulars of the affairs of the corporation.<sup>14</sup>

### ***Canada Corporations Act***

The *Canada Corporations Act*, which governs federally incorporated non-share capital corporations, is very specific with regard to what the by-laws must contain. The by-laws must accompany the application for the letters patent and contain:

- a) Conditions of membership, including societies or companies becoming members of the corporation;
- b) Mode of holding meetings, provisions for quorum, rights of voting and of enacting by-laws;
- c) Mode of repealing or amending by-laws with special provision that the repeal or amendment of by-laws not embodied in the letters patent shall not be enforced or acted upon until the approval of the Minister has been obtained;

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<sup>13</sup> *Ibid.* at 3-7 to 3-8.

<sup>14</sup> *Supra* note 2 at s. 129.

- d) Appointment and removal of directors, trustees, committees and officers and their respective powers and remuneration;
- e) Audit of accounts and appointment of auditors;
- f) Whether or how members may withdraw from the corporation; and
- g) Custody of the corporate seal and certifying of documents issued by the corporation.<sup>15</sup>

### 3. Annual Meetings

Another problem among the inter-related non-share capital corporations in *Rexdale Singh Sabha Religious Centre v. Chattha* was that the board of directors were not calling any members' meetings. In this regard, the following provision is concerned with the calling of a members' meeting, and is relevant to non-share capital corporations incorporated federally under the *Canada Corporations Act*:

- ♦ Section 102(1) – Annual Meetings – An annual meeting of the [members] of the company shall be held at some date not later than eighteen months after the incorporation of the company and subsequently once at least in every calendar year and not more than fifteen months after the holding of the last preceding annual meeting.<sup>16</sup>

The following provision is relevant to the calling of a members' meeting for non-share capital corporations in Ontario incorporated provincially under the *Corporations Act*:

- ♦ Section 293 – Annual meetings – A corporation shall hold an annual meeting of its shareholders or members not later than eighteen months after its incorporation and subsequently not more than fifteen months after the holding of the last preceding annual meeting.<sup>17</sup>

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<sup>15</sup> *Canada Corporations Act*, R.S.C. 1970, c. C-32, s. 155(2).

<sup>16</sup> *Ibid.* at s. 102(1).

<sup>17</sup> *Supra* note 2 at s. 293.

## H. CONCLUSION

This brief overview of *Rexdale Singh Sabha Religious Centre v. Chattha* and the additional commentary highlight the importance of complying with corporate governance issues for both charitable and not-for-profit organizations. From the outset, an organization's by-laws must be carefully drafted and adopted on a timely basis. The by-laws and applicable legislation must then be consistently followed by both the board of directors and the membership of the corporation. Basic corporate compliance in the fundamentals will assist in averting potential disputes or at least to ensure that they are handled in accordance with the requirements of the applicable corporate statute.



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