CARTERS.ca

CHARITY LAW BULLETIN NO. 120

CARTERS PROFESSIONAL CORPORATION
Barristers, Solicitors & Trade-mark Agents / Avocats et agents de marques de commerce
Affiliated with **Fasken Martineau DuMoulin LLP** / Affilié avec Fasken Martineau DuMoulin S.E.N.C.R.L., s.r.l.

JULY 31, 2007

Editor: Terrance S. Carter

COMMENTS ON A CONSULTATION PAPER FOR REFORM OF THE *CORPORATIONS ACT* (ONTARIO)

By Jacqueline M. Demczur, B.A., LL.B.
Assisted by Dawn E. Phillips, B.A., LL.B. Candidate

A. INTRODUCTION

The Ontario Ministry of Government Services ("Ministry") recently released their first consultation paper on reform to the Ontario *Corporations Act* ("OCA"). This consultation paper, *Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations*[1], marks the Ministry's first step in a project that aims to develop a new framework for governing the structure and activities of charities and not-for-profit corporations in Ontario. The consultation paper focuses on a number of broad issues, each of which the Ministry has provided background information and consideration questions for. They have also invited feedback on the consultation paper from stakeholders and the public to assist them in developing draft reform legislation. This *Charity Law Bulletin* ("Bulletin") will briefly summarize the issues that are focused on in the paper and will highlight some questions that the Ministry will need to address before they can implement actual reform to the OCA.

B. THE NEED FOR REFORM

The primary basis for proposing reform to the OCA was concern that the OCA is antiquated, cumbersome, and unable to meet requirements of the modern not-for-profit sector. The original version of the OCA, the

[1] Ministry of Government Services, Policy and Consumer protection Services Division, *Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations*, Consultation Paper, May 7, 2007. The paper can be found at <http://www.gov.on.ca/MGS/en/AbtMin/132784.html>.

called the *Companies Act*, was enacted in 1907 and has not been substantially revised since 1953. During this 50 year period where there has been no substantial change to legislation, the not-for-profit sector itself has experienced tremendous change. It is hoped that reform to the OCA will both achieve modernization of the Act and facilitate a legal structure that equates with the actual needs of today's not-for-profit organizations.

C. THE INCORPORATION PROCESS

Presently, incorporation under the OCA requires that not-for-profit organizations file an application for letters patent along with supporting documentation and a fee. The Ministry then reviews this application and supporting documentation, and uses discretion to identify which organizations should be approved for incorporation. The consultation paper recognizes that perhaps this discretion can cause government officials to impose unnecessary restrictions on applicants. Since the imposition of these restrictions runs contrary to the OCA's main objective of encouraging and facilitating not-for profit activity, this is an area where reform is likely to occur.

As an alternative to the current system, the Ministry has proposed that the new Act might provide organizations with the ability to incorporate "as of right". Under this process, applications for incorporation would be automatically approved once basic requirements for incorporation are established. This would limit the scope of the Ministry's review and would also allow the incorporation process to proceed quickly.

To integrate an "as of right" system, the Ministry will be required to determine what the basic requirements of incorporation should be and how to apply an "as of right" system to charitable not-for-profit organizations. They must also take on the difficult task of determining to what extent the new Act should be concerned with the objects and powers of a corporation. This consideration will require extreme mindfulness as to how reform may influence the current legal requirements for maintaining a charitable purpose.

D. THE STRUCTURE OF THE OCA

The current Act is difficult to navigate and its structure requires replacement. These difficulties have led the Ministry to propose two potential models for a new structure: The Ontario *Business Corporations Act* ("OBCA") or the *California Corporations Code* ("CCC").

Structurally, the OBCA is very logical. Section by section it follows the chronology of a corporation and the central issues that need to be addressed by corporate legislation (e.g. incorporation, membership, directors and officers, remedies). The OBCA did form the structural basis for proposed *Canada Not-for-profit Corporations Act* ("Bill C-21"), which, however, was unsuccessful in receiving Parliament's support. Further, the OBCA structure is designed for business corporations and could be criticized as less suitable to the needs of not-for-profit corporations.

The CCC is what might be described as 'divided legislation'. It contains various sections for various designated types of not-for-profit corporations and in each section it addresses all things relevant to that type of corporation. While the CCC model is user-friendly, it is also quite lengthy. Further, under a CCC model, problems can arise in determining how to the different corporations should be classified.

As can be seen, neither model is totally suitable for the new Act to follow. As well, there may be other potential models that are not listed in the consultation paper that may be more appropriate to utilize. It is possible that the Ministry will ultimately find that they should combine the best features of various models in order to meet the unique needs of not-for-profit organizations in Ontario.

E. DEFINING THE TERM 'NOT-FOR-PROFIT CORPORATION'

The consultation paper divides the framework for examining the definition of 'not-for-profit corporation' into two separate components: not-for profit purposes and non-distribution constraints. Not-for profit purposes refer to the requirement that not-for-profit corporations pursue purposes other than profit or pecuniary advantage to their members. Non-distribution constraints refer to the nature of not-for-profit corporations as being different from business or commercial entities, in that they do not distribute property to their members.

1. Not-for-profit purposes

   As suggested, the current Act permits a not-for-profit organization to become incorporated with any objects within the jurisdiction of Ontario and requires not-for-profit corporations to be carried on without the purpose of gain for its members. What is problematic about the current Act is that the term 'gain for members' has no clear meaning and it has been interpreted to permit the incorporation of associations that indirectly advance the pecuniary interest of their members by advancing a common interest (e.g. trade associations).

In its reform, the Ministry is considering a more clearly defined list of permitted purposes and activities. It is further considering the explicit exclusion of any form of gain to members. In making these considerations, the Ministry must consider how the new Act should regulate the degree of for-profit activities that not-for-profit corporations are permitted to carry out. They must also consider whether exceptions to the restrictions on for-profit activity should be provided to certain corporations.

2. Non-Distribution Constraint

Currently, the OCA specifies that a not-for-profit corporation must carry its operations on without the purpose of gain for its members. However, the wording of the OCA is not so explicit so as to provide a non-distribution constraint. In fact, the OCA has been interpreted as allowing certain corporations the distribution of assets to corporate members upon dissolution. Of course, charitable not-for-profit corporations are prohibited from distributing funds to their members, which creates some confusion in relation to this aspect of the current Act. The Ministry will be required to examine other available non-distribution constraint techniques to determine how the new Act can best to approach the ability of not-for-profit corporations to distribute assets.

F. CLASSIFICATION SYSTEM

The current Act only provides for one class of not-for-profit corporation, being a class which is made up of corporations whose objects are within the jurisdiction of the Province of Ontario. Reform to the OCA has called into question whether Ontario not-for-profit corporations would be better served if the OCA took their diversity into account and categorized them into several different classes and regulated each class according to their common features. The CCC model takes a similar approach.

The Ministry must determine if a class model is desirable and, if it is, they must evaluate a variety of different classification models that could be used. The *Saskatchewan Non-Profit Corporations Act*, 1995 categorizes not-for-profit corporations as either charitable corporations or membership corporations, and then more stringently restricts the ability of charitable corporations to make fundamental changes to its object and distribution clause. Bill C-21 distinguished between soliciting corporations and non-soliciting corporations, with soliciting corporations being more heavily regulated because they are corporations that solicit funds from the public, government or other entities. The CCC classifies corporations as mutual benefit, public benefit or religious, with public benefit corporations being the most heavily regulated.

The Ministry has already proposed certain areas where different classes of corporations might be treated differently. They suggest that the distribution of assets on dissolution, the payment of remuneration to directors, and members' rights and remedies are, for example, areas where differences between not-for-profit corporations may require that organizations are regulated differently.

Distinguishing between corporations in the manner proposed does seem at first glance somewhat logical. Not-for-profit corporations can vary tremendously from one corporation to another and a regulatory system that looks to those differences may better address specific corporate needs. Yet this classification of not-for-profit corporations could also foster a regulatory regime that forces corporations to fit into a specific class description without properly considering how that exact corporation should be regulated. This is particularly of potential concern for religious corporations. .Possibly an alternative approach to a classification system would involve having certain provisions that apply to all corporations, together with optional provisions that could be chosen to customize particular corporations depending upon their intended purposes and activities.

G. CORPORATE POWERS AND CAPACITY

Under the current Act, a not-for-profit corporation has the capacity of a natural person and the ability to exercise its powers outside of Ontario. The OCA, however, prescribes that a corporation's ability as a natural person can be limited by the OCA or the bylaws of the corporation. This preserves the doctrine of *ultra vires* which declares that actions of a corporation that are beyond its power will be considered void.

Many other corporate statutes that regulate both business and not-for-profit corporations have abolished this doctrine of *ultra vires*. Rather than making actions void if they are committed outside of corporate power, these statutes simply make the actions illegal and subject to general legal sanctions.

The Ministry has not proposed that the doctrine of *ultra vires* will be absolutely abolished. It has, however, raised several questions, the answers to which may outline the benefits and drawbacks of maintaining this doctrine. Given the recent trend for the abandonment of the doctrine by other corporate legislation, it is likely that the doctrine of *ultra vires* will not form a part of the new Act.

H. OTHER RELEVANT ISSUES AND CONSIDERATIONS

The Ministry's consultation paper also raises questions surrounding the nature of the reform as it will pertain to the more specific topic of directors' and officers' liability, financial disclosure and members' remedies. It suggests that more detailed papers will be released on these topics but, as a preliminary measure, feedback is invited.

1. Directors' and Officers' Liability

   The current Act sets out no duty of care, standard of care or defences that are applicable to the directors and officers of not-for-profit corporations. The Ministry notes that the not-for-profit sector often experiences difficulty in recruiting and retaining qualified individuals to fill these positions. The current lack of attention that this topic receives under the OCA opens directors and officers to personal liability in a number of ways and thus serves as a deterrent to individuals who might otherwise wish to accept a director or officer position within a not-for-profit corporation.

   The Ministry will be required to create a liability regime that takes into account the need for directors and officers to be treated fairly, while still being accountable to those who suffer losses as a result of the actions of a director, officer, or corporation.

2. Financial Disclosure

   The current Act has specific requirements for financial disclosure but it does not require financial disclosure to the public or to the members of the corporation. Although some corporations are required to provide this financial disclosure because of Canada Revenue Agency requirements, the Ministry must determine if there is a level of financial disclosure that should be required of all not-for-profit corporations.

3. Members' Remedies

   Although the current Act does provide several remedies for members of not-for-profit corporations, it does not provide for an oppression remedy, a derivative action, the right to dissent and appraisal, or provisions for a fair hearing and natural justice. The Ministry is attempting to determine whether these

remedies should be extended to members of not-for-profit corporations and whether, in addition to introducing new remedies, the current remedies should be broadened or altered.

I. CONCLUSION

The consultation paper discussed in this Bulletin is a promising first step towards the Ministry's goal of reforming the OCA to produce a modern piece of legislation. The Ministry has presented several important issues in this paper and has carefully considered the questions which emerge from each of these issues. Further, in identifying these questions and providing some background, this paper will foster an informed consultation with the public and with not-for-profit stakeholders—asking concerned parties to really think about the questions and ensuring that various possibilities for reform remain open for consideration.

CARTERS.ca

CARTERS PROFESSIONAL CORPORATION
Société professionnelle Carters
Barristers, Solicitors & Trade-mark Agents
Affiliated with **Fasken Martineau DuMoulin LLP**
Avocats et agents de marques de commerce
Affilié avec Fasken Martineau DuMoulin S.E.N.C.R.L., s.r.l.

Offices / Bureaux
Ottawa (613) 235-4774
Mississauga (416) 675-3766
Orangeville (519) 942-0001
Toll Free: 1-877-942-0001

By Appointment / Par rendez-vous
Toronto (416) 675-3766
London (519) 937-2333
Vancouver (877) 942-0001

www.charitylaw.ca