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Recent Corporate Law Reform: Overview and Practical Tips

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TOPICS FOR REVIEW

- Part I: The *Canada Not-For-Profit Corporations Act* (“CNCA”)
- Part II: The Ontario *Not-For-Profit Corporations Act* (“ONCA”)
- For both CNCA and ONCA the following will be discussed:
  1. Historical Context
  2. Overview of the Key Elements
  3. Ongoing Concerns
  4. Practical Tips

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PART I: *CANADA NOT-FOR-PROFIT CORPORATIONS ACT (“CNCA”)*

1. Historical Context

- There have been several attempts at legislative reform to the *Canada Corporations Act* (“CCA”) since 1917
- On June 23, 2009 *Canada Not-for-Profit Corporations Act* (“CNCA”) received Royal Assent, but not yet proclaimed in force
- Draft regulations were published by Industry Canada on June 25, 2010 but not yet finalized
- Estimated that CNCA will likely come into force in mid 2011

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2. Overview of the Key Elements of the CNCA

- Simplified Process of Incorporation
  - Incorporation "as a right" (s.9)
  - One incorporator (individual or corporation) (s.6)
  - No legal element, like "corp" needed and same name clearance rules as CCA (ss.11, 13)
  - Results in certificate of incorporation instead of letters patent

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- Capacity and Powers (Sections 16 & 17)
  - A corporation has the capacity and rights of a natural person
  - Concept of a corporation's activities *being ultra vires* now eliminated
  - CNCA does not require the passage of a by-law to confer any particular powers on the corporation or its directors

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- By-laws: Enactment/Amendment/Repeal
  - Effective upon passage by the board (unless an amendment providing for a fundamental change, such as changing the manner of giving notice to members entitled to vote at a meeting of the members) (s.152(3))
  - Must be confirmed by members at next meeting to remain in force (s.152(2))
  - Members may also initiate amendment or repeal of by-laws (s.152(6))
  - No Ministerial approval of by-laws needed, although must file by-laws with Industry Canada ("IC") within 12 months of membership approval (but failure to file does not affect validity) (s.153)

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- Directors – Number and Change
  - Minimum of 1 director (3 for a soliciting corporation, at least 2 of whom are not officers or employees of the corporation or its affiliates) (s.125)
  - Ex-officio directors not permitted
  - Must file notice of change within 15 days of any change or of a change in a director's address (s.134)

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- Directors Taking Office
  - Elected by members by ordinary resolution at an annual meeting for a term expiring within prescribed period of 4 years (s.128(3))
  - May have staggered terms (s.128(4))
  - Articles can provide for appointment of directors by board (up to 1/3 of those elected at previous AGM) (s.128(8))

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- Due Diligence Defence – Directors and Officers (ss.149,150)
  - Not liable if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances
  - Good faith reliance on financial statements and reports of professionals

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- Members' Rights
  - Access to membership lists (s.23)
  - Right to submit proposals to amend by-laws or nominate directors or require any matter to be discussed at annual meetings (s.152(6))
  - Right to access corporate records (s.22)
  - May sign resolutions in writing (s. 166)
  - Availability of unanimous members agreement (except for soliciting corporations) (s.170)

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- Members' Remedies
  - Right to seek an oppression remedy against the corporation (s.253)
  - Right to seek a court order to commence a derivative action (s.251)
  - Compliance and restraining orders (s.259)
  - Court ordered wind-up and liquidation on application of a member (s.224)

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- Special Exemption for Religious Corporations
  - CNCA precludes the members' remedies, referred to above where the court determines that:
    - The corporation is a religious corporation
    - The act or omission, conduct or exercise of powers is based on a tenet of faith held by the members of the corporation; and
    - It was reasonable to base the decision on a tenet of faith, having regard to the activities of the corporation (ss. 251(3), 253(2) and 224(2))

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- Members' Meetings
  - Regulations provides a variety of prescribed means of giving notice of members meetings
  - Absentee voting – By-law can set out any prescribed method of absentee voting (mail in ballot, electronic voting or proxy) (s.171)
  - May participate in members' meetings by electronic means (s. 159(4)(5))
  - By-laws can provide for consensus decision making (s.137)
  - Right to requisition a meeting of members (s.167)

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- All classes of members, even non-voting classes of members, are entitled to vote separately as a class on certain amendments to articles and by-laws dealing with rights and classes of membership (s.199(1))
  - Voting takes place amongst classes. Thus a class of members may reject a change. This can result in a class veto for fundamental changes (limited opt-out available) (s.199(3))

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- Soliciting and non-soliciting corporations (s.2(5.1))
  - Where a corporation receives in excess of the prescribed amount [$10,000] in its last financial period from public sources [(a) public donations, (b)federal, provincial and municipal governments or (c) conduit entities], it will become a soliciting corporation
  - Status acquired on the prescribed date [AGM] for a prescribed duration [3 years]
  - Low threshold means most charities and non-profits will become soliciting corporations

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- Implications of being a soliciting corporation
  - Must have a minimum of 3 directors, at least 2 of whom are not officers or employees of the corporation or its affiliates (s.125)
  - Required to file annual financial statements with The Director under s. 176(1)
  - Audit and public accountant rules more stringent (see next slide)
  - On liquidation, the articles must provide for the distribution of any remaining property on dissolution to qualified donees (s.235(1))

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Public Accountant and Audit Requirements

Type of Corp/Gross Annual Revenues (GAR)		Requirements for Public Accountant (PA)	Review/Audit
SOLICITING corporation with GAR of→	Less than $50,000	A PA must be appointed annually (s.181) *or* members can waive appointment but waiver must be done unanimously annually (s.182)	If PA is appointed, review engagement is required (s.188(1)) but members can vote by simple majority to require an audit instead (s.188(2))
	Between $50,000 and $250,000	PA must be appointed annually (s.181)	Audit is required (s.189(1)) but members can agree by 2/3 majority to have a review engagement instead (s.189(2))
	Over $250,000	PA must be appointed annually (s.181)	Audit is required (s.189(2))

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Type of Corp/Gross Annual Revenues (GAR)		Requirements for Public Accountant (PA)	Review/Audit
NON-SOLICITING corporation with GAR of →	Less than $1M	A PA must be appointed annually (s.181) *or* members can waive appointment but waiver must be done unanimously annually (s.182)	If PA is appointed, review engagement is required (s.188(1)) but members can vote by simple majority to require an audit instead (s.188(2))
	Over $1M	PA must be appointed annually (s.181)	Audit is required (s.189(1))

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- Continuing under the CNCA
  - All existing CCA corporations will be required to continue under the CNCA within 3 years of it coming into force or face possibility of dissolution (s.297)
  - Content of articles of continuance similar to articles of incorporation under s.7
  - Can make amendments to its articles, letters patent or memorandum or articles of association, at the same time as applying for continuance (s.211(2))

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3. Ongoing Concerns with the CNCA

- Definition of soliciting corporation [$10,000] threshold is too low
- Directors must be elected. There is no provision for ex-officio directors
- Non-profits that are soliciting face a predicament on dissolution (i.e. to “qualified donees”)
- Different approval requirements (i.e. simple v. 2/3 majority) for by-laws may be difficult to administer

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- Non-voting members have a right to vote to approve certain fundamental changes
- Filing of financial statements by soliciting corporations with The Director and the level of financial review imposes an increased burden on soliciting corporations
- Amendment of charitable objects on continuance expected to trigger CRA review
- CRA to develop policy on requirements for charities continuing under CNCA (current estimated number of 7,600 federally incorporated charities)

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4. Practical Tips

- Soliciting v. Non-Soliciting
  - Given the low threshold, better to assume that a corporation will be a soliciting corporation
  - But will need to be familiar with enhanced requirements
- Timing of Continuance
  - Corporations may wish to continue early or delay continuance depending upon circumstances of their particular situation

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- Some factors to consider in timing:
  - CNCA increased director protection
  - CNCA enhanced rights to members
  - Do by-laws and/or letters patent require amendment in any event
  - Possible change of objects might be accomplished more easily with CRA in the continuance process
  - CNCA different levels of accountant/audit requirements
  - Contemplation of fundamental changes and the rights afforded to non-voting members

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- By-Laws
  - CNCA will contain much of what used to be required in the by-laws
  - Therefore a minimalist approach to by-law drafting
  - But still some provisions where the by-laws will need to reflect choices, such as membership conditions, notice of meetings of members, absentee voting by members, discipline of members, quorum, consensus decision making, appointment and removal of directors
  - Avoid non-voting membership class where possible
  - Amending formulas need to reflect on simple v. 2/3 majority

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- Directors
  - Ex-officio directors are not permitted. However, it may be possible to consider "work arounds"
  - For instance, having special membership class of one member, which class would have the right to elect a director
  - Or possible for the articles to provide for the appointment of directors by the board under s.128(8) and then have a board policy that certain office holders will be appointed as a director of the corporation

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PART II: ONTARIO *NOT-FOR-PROFIT CORPORATIONS ACT ("ONCA")*

1. Historical Context

- The Ontario *Corporation Act* ("OCA") has not been substantively amended since 1953
- Bill 65 introduced the new Ontario *Not-For-Profit Corporations Act ("ONCA")*
- ONCA introduced on May 12, 2010 and received Royal Assent on October 25, 2010
- However, ONCA not expected to be proclaimed in force until sometime in 2012
- Regulations have not yet been released

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2. Overview of the Key Elements of the ONCA

- Simplified Process of Incorporation
  - Replaces the letters patent system with a statutory regime similar to CNCA and OBCA
  - Removes ministerial discretion to incorporate in that incorporation is as a right (s.9)
  - Only one incorporator needed (individual or corporation) (s.7)
  - Results in certificate of incorporation instead of letters patent (s.9)

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- Capacity and Powers (Sections 15 to 20)
  - A corporation under the ONCA has the capacity and rights of a natural person
  - Concept of a corporation's activities *being ultra vires* now eliminated under the ONCA
  - CNCA does not require the passage of a by-law to confer any particular powers on the corporation or its directors

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- Public Benefit Corporations (PBC)
  - Public Benefit Corporations (PBC) include
    - A charitable corporation (at common law), or
    - A non-charitable corporation that receives more than $10,000 in a fiscal year in funding from public donations or the federal or provincial governments, or a municipality (1(1))
  - When a non-charitable corporation reaches the $10,000 threshold, the PBC status won't attach until the first annual meeting of members in the next fiscal year (s.1(2))

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- Consequences of Being a Public Benefit Corporations (PBC)
  - Not more than one-third of the directors of a PBC may be employees of the corporation or of any of its affiliates. (23(3))
  - Higher thresholds for dispensing with the auditor and/or review engagement as explained below

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- On liquidation, the articles must provide for the distribution of any remaining property on dissolution to
  - If it is a charitable corporation, to a charitable corporation with similar purposes to its own or to a government or government agency,
  - If it is a non-charitable corporation, to another public benefit corporation with similar purposes to its own or to a government or government agency (s.167(1))

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- Directors – Number and Change
  - Minimum of 3 directors. Directors are elected at meetings of members (s.22)
  - The board may appoint one or more additional directors as long as the number of appointed directors does not exceed one-third the number of elected directors. The term of appointment lasts until the next AGM (s.24(7))

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- Directors – Number and Change
  - Unlike CNCA, ONCA specifically permits ex-officio directors (s.23(4))
  - Four year terms (maximum) (s.24(1))
- Directors and Officers – Duties
  - Same as CNCA. Every director and officer has a duty to:
    - Act honestly and in good faith with a view to the best interests of the corporation
    - Exercise the care, diligence and skill of a reasonably prudent person (s.43)

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- Due Diligence Defence – Directors and Officers
  - Generally the same as CNCA
  - Not liable if exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances
  - Good faith reliance on financial statements and reports of professionals (s.44)

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- Members' Rights
  - A member entitled to vote at an annual meeting may raise any matter as a "proposal" but must give 60 days notice. Directors can refuse to discuss the proposal if they give at least 10 days notice, but a member may appeal the refusal decision to court (s. 56)
  - Members may requisition meetings of the members (but need 10% of the votes to do so, or lower if the by-laws so states) (s.60)
  - Right to access membership lists (96(1))
  - Right to inspect financial records (s.98(2))

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- Members' Remedies
  - Unlike the CNCA, no oppression remedy exists under the ONCA
  - Right to seek a court order to commence a derivative action (s.183)
  - Derivative action is not available with regard to religious corporations (s.183(3)), but religious corporations not defined

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- Non-voting members are given voting rights in some limited circumstances
  - An extraordinary sale (which is defined as a “lease or exchange of all or substantially all of the property of the corporation”) (s. 118(1))
  - An amalgamation (s.111(3))
  - A change to any rights or conditions attached to those non-voting members or a change in the rights of other classes of members relative to the rights of the non-voting members (s. 103(1)(e))

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Audit Requirements

Type of Corp/Gross Annual Revenues (GAR)		Requirements for an Auditor	Audit/Review Engagement
Public Benefit Corporation (PBC) with GAR of →	Less than $100,000 (s.76(1)(b))	May, by extraordinary resolution (80%), decide not to appoint an auditor	May dispense with both an audit and a review engagement by extraordinary resolution (80%)
	Over $100,000 but less than $500,000 (s.76(1)(a))	May dispense with an auditor and have someone else conduct a review engagement. This requires an extraordinary resolution (80%)	May elect to have a review engagement instead of an audit by extraordinary resolution (80%)
	Over $500,000 (s.68)	An auditor must be appointed annually	Audit is required

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Type of Corp/Gross Annual Revenues (GAR)		Requirements for an Auditor	Audit/Review Engagement
NON-PBC corporation with GAR of →	Less than $500,000 in annual revenues (s.76(2)(b))	May, by extraordinary resolution (80%), decide not to appoint an auditor	May dispense with both an audit and a review engagement by extraordinary resolution (80%)
	Over $500,000 (s.76(2)(a))	May, by extraordinary resolution (80%), dispense with an auditor and have someone else conduct a review engagement.	May elect to have a review engagement instead of an audit by extraordinary resolution (80%)

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- Continuing under the ONCA
  - Existing OCA corporations will be required to continue under the ONCA within 3 years of it coming into force (s. 207)
  - Social clubs with share capital will have 5 years (s.211)
  - OCA corporations can, by articles of amendment, amend any provision in its letters patent, supplementary letters patent, by-laws or special resolution to bring the provision into conformity with the ONCA (s.207)

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3. Ongoing Concerns with the ONCA
   - Definition of PBC [$10,000] threshold is too low
   - Non-voting members rights to vote on fundamental changes may lead to problems, i.e. churches and other large membership based organizations

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- Weak liability protection, as the government rejected the recommendation to include a partial liability shield for directors. Due diligence defence by itself not adequate
- Mandatory provision requiring solicitation of proxies instead of allowing a corporation to structure its own decision making process regarding absentee members (i.e. allowing an option to vote by secret mail in or by electronic ballot) (s.65)

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4. Some Practical Tips
- PBC v. Non-PBC
  - Given the low threshold, better to assume that a corporation will be in the PBC category
  - But will need to plan accordingly as a PBC
- Timing of continuance
  - Similar comments as with CNCA
  - However, the option to continue will not occur until sometime in 2012
  - Therefore, there will be a hiatus time period over the next two years where Ontario corporations will operate under the OCA but will need to be aware of changes to come

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- By-laws
  - ONCA will contain much of what used to be required in the by-laws
  - The result will be minimalist approach to by-law drafting similar to the CNCA
  - Need to pass by-laws early on. If by-laws are not passed within 60 days after incorporation, the corporation will be deemed to have passed the standard by-laws approved by The Director (s.18)
  - Avoid creating class of non-voting members where possible

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- Directors
  - More flexibility than under OCA. For instance, directors do not have to be members
  - For PBCs, not more than one-third of the directors may be officers or employees of the corporation or its affiliates
  - Unlike CNCA, ONCA allows ex-officio directors
  - Unlike the CNCA, an ONCA corporation does not need to specify in the articles for the appointment of additional directors

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- Commercial Activity
  - If any of the purposes are of a commercial nature, the articles must state that the commercial purpose is intended only to advance or support one or more of the corporation's not-for-profit purposes (s.8(3))
  - For charities, this corporate authority must be read subject to the restrictions under the *Income Tax Act* for related business

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