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**DRAFTING BY-LAWS:
PITFALLS TO AVOID**


By Esther S. J. Oh, B.A., LL.B.

estheroh@carters.ca
1-877-942-0001

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TOLL FREE: 1-877-942-0001

Toronto (416) 675-3766 Ottawa (613) 235-4774
Orangeville (519) 942-0001
www.carters.ca www.charitylaw.ca



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Drafting By-laws: Pitfalls to Avoid

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A. INTRODUCTORY COMMENTS

- All not-for-profit corporations are governed by the following corporate documents:
 - Letters patent or articles
 - Sets out the corporate name, the purposes, dissolution clause and other important provisions
 - General operating by-law which reflects the governance structure
 - Outlines director qualifications and terms, classes and qualifications of membership, procedures that apply to director and membership meetings, officer positions and other important governance matters
- Not-for-profit corporations can include churches, charities or non-profit organizations under the *Income Tax Act*
 - collectively referred to as “NFP Corporations” or “NFPs” in this presentation

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- Different types of NFPs
 - Federal incorporation under *Canada Not-for-Profit Corporations Act* (“CNCA”)
 - Provincial incorporation under *Ontario Corporations Act* (“OCA”) which will be replaced by the *Ontario Not-for-Profit Corporations Act* (“ONCA”) or other provincial statute
 - Incorporation under special legislation or other statutes
- Different legal requirements apply to an NFP depending on its governing statute
- This presentation focuses on issues that are of general application, to all NFPs with some references to the CNCA and the OCA

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- From time to time, NFPs may need to amend their general operating by-laws in order to reflect updated legal requirements or to address changes to their governance or operations
 - A new general operating by-law can be prepared to replace the entirety of the previous by-law
 - Where an NFP wishes to amend only specific sections of an existing by-law, a shorter by-law amendment can be adopted
 - This presentation reviews selected examples of “pitfalls” to avoid when an NFP is drafting a new by-law or amending an existing by-law
 - Legal advice should be sought as the rules involving corporate law can be complicated


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B. TIPS ON ADMINISTRATIVE “PITFALLS” TO AVOID WHEN PREPARING BY-LAWS

1. Numbering of By-laws

- By-laws should be numbered sequentially in the order that they are adopted
 - Sequential numbering should be done with all by-laws (including general operating by-laws and shorter by-law amendments)
 - *i.e.* By-law No. 1, By-law No. 2, By-law No. 3 and so on
 - Using the title of “By-law No. 1” for all by-laws for an NFP can be confusing as to the order in which they were approved




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2. Retaining Signed and Dated Copies of By-laws

- By-laws should always be signed and dated as of the date that membership approval has been obtained
 - Under OCA the directors may pass by-laws that which are effective as of the date of board approval but only until confirmed at the next annual meeting of members
- A signed and dated copy of each by-law should be kept within the appropriate by-law tab within the corporate minute book of an NFP



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3. Avoiding Frequent By-law Amendments

- Some NFPs may be in the habit of amending their by-law every year. However, this practice should be avoided for the following reasons:
 - Complexities and inconsistencies can easily occur with frequent amendments to a by-law
 - On-going amendments to by-laws divert resources of the NFP away from its purposes

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4. Transparency and Collaboration When Seeking Membership Approval Over By-law Amendment

- For open membership corporations, appropriate communication and consultation can be done with members prior to presenting a by-law amendment
- For suggestions on steps that can be taken to seek membership approval over a by-law amendment in a collaborative manner, please see webinar material dated November 9, 2017 entitled "Corporate Documents and Procedures to Help Avoid Governance Disputes" at www.carters.ca

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C. LEGAL CONSIDERATIONS

1. Importance of Working With Legal Counsel To Ensure Accuracy and Coherency of By-laws

- A by-law that is clearly drafted, self-explanatory, and compliant with applicable legal requirements can help to avoid confusion and potential disputes regarding the by-law
- NFP corporations are encouraged to work with their respective legal counsel when preparing a new by-law or amending an existing by-law

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2. Importance of Following Correct Procedures at Board and Membership Meetings To Approve By-law

- When amending by-laws, it is important to obtain the necessary approvals outlined in an existing by-law, including the following:
 - Director approval requirements
 - Membership approval requirements
 - Notice of membership meetings to be given
 - Approvals or consultations required from a third party, such as a founding member or a denomination for a local church (if applicable)



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D. GENERAL DRAFTING PITFALLS TO BE AVOIDED

1. Pitfalls To Be Avoided By All NFPs

The following slides provide selected examples of drafting pitfalls that are of general application to all NFPs

- Avoid using a boilerplate by-law that was originally developed for a for-profit corporation
 - A by-law should reflect the unique governance and operational needs of the NFP and should also reflect the applicable laws that apply to the NFP
- Avoid inaccurate and/or outdated descriptions of director and/or membership qualifications in the NFP's by-law
 - e.g. where a corporation operates as a closed membership corporation, the by-law should reflect the same

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- A closed membership structure can be established by requiring that membership is restricted to only those persons who are directors
- All applications for membership should be made subject to approval by the board of directors
- Avoid lack of clarity on requirements that apply where members are subject to one-year terms
 - Where NFPs have one-year terms for members, the by-law should clearly indicate when membership term begins and ends and the deadline by which annual membership fees if applicable must be paid to preserve voting rights

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- Avoid lack of consistency between provisions within the by-law and provisions within the letters patent/articles of incorporation
 - e.g. In some cases, by-laws contain purposes that have been updated over the years, but are different from the purposes in the original letters patent or articles of incorporation
- Avoid lack of consistency between the policies of the NFP and the by-law
 - e.g. Conflict of interest provisions within a board policy need to be consistent with the Conflict of interest provision in the by-law

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2. Importance of Transition Provisions

- Amendments to an existing by-law may involve changes to by-law provisions that are completely different from those in an existing by-law
- Where this applies, it is important that the new by-law outline a clear procedure to be followed to help the NFP transition to the new by-law requirements
 - For example, a new by-law might outline the following changes to director terms:
 - A change to the term to be served by directors from a one year term (in the existing by-law) to a three year term (under the new by-law)
 - A change to the maximum term to be served by directors, from *no* maximum term (under the existing by-law) to a maximum term of three consecutive terms (under the new by-law)


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- In this example it is essential that the by-law contain a transition provision outlining how terms and maximum terms for directors are to be calculated
 - The transition provision could indicate that on the date that the new by-law is adopted, each existing director will stand for election to the board and will be deemed to start the first year of the new three year term
 - The transition provision could also indicate that on the date that the new by-law is adopted, each director elected to the board is deemed to start the first term (of a maximum three possible terms) to be served by each director set out in the new by-law

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- i.e. each director elected on the date the new by-law is adopted can serve for a maximum of three consecutive three year terms (i.e. 9 consecutive years) according to the new term and maximum term outlined in the new by-law
- Without a clear transition provision that sets out how the director terms are to be calculated under the new by-law, considerable confusion can arise when trying to determine the terms that may be served by the elected directors on the date the by-law is adopted
 - This is of particular importance where individuals have already served on the board for several years immediately before adoption of the new by-law

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- Amendments to an existing by-law might also include a change that is fundamental to the governance of the members
 - It is essential that the new by-law must outline the steps to be followed to transition from the provisions of the existing by-law to the new requirements under the new by-law
 - For example, under an existing by-law an NFP might have three classes of members. However, the NFP might want to restructure its membership to reflect only one class of members under the new by-law



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- In that case, it would be important to ensure that the new by-law contains a transition provision outlining what is to occur with members who are in the membership classes that will be eliminated under the new by-law
 - As one option, the NFP might want to indicate that the members in membership class #2 and #3 (which are outlined in the existing by-law but are being removed under the new by-law) will become members under membership class #1 (which is being retained under the new by-law)



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- Without transition provisions outlining a clear process to be followed, an NFP's governance could experience uncertainty and confusion
- Lack of clarity on how to transition to a new by-law can also invite legal challenges on the validity of the new by-law, the status of the directors and the status of members under the new by-law




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E. SPECIFIC DRAFTING PITFALLS TO BE AVOIDED UNDER THE CNCA

1. Careful Review of Mandatory, Default and Optional Clauses Under the CNCA

- Rules that apply under the CNCA and the regulations are highly complex
- Under the CNCA, there are different types of rules that apply to by-laws, which are set out in both the CNCA and the regulations under the CNCA
 - Mandatory rules that cannot be overridden by the articles or by-law
 - Default rules, that apply automatically where the by-laws for an NFP are silent on a given issue
 - Default rules can be overridden by provisions within the articles or by-laws



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- Optional rules which can be included within the by-laws of an NFP
 - Optional rules would not apply if the by-laws of the NFP are silent on those issues
- In order to avoid having to regularly consult the lengthy CNCA provisions and regulations to understand the requirements that apply to their NFP, the following can be done:
 - Prepare a comprehensive by-law that contains:
 - Key CNCA provisions on mandatory rules
 - The NFP's desired default provisions
 - The NFP's desired optional provisions
 - This can help to streamline matters and avoid considerable confusion

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2. Rights Given to Non-Voting Members Under CNCA


- Under the CNCA, complex rules apply when an NFP has more than one class of members
- If an NFP has two or more classes of members, members of each class of members will be entitled to vote separately as a class if the corporation wants to make certain changes, regardless of whether the membership class is a voting class or non-voting class
- Separate class votes are required for:
 - Fundamental changes (such as amalgamation, the sale, lease or exchange of all or substantially all of the property of a corporation, other than in the ordinary course of its activities)
 - Certain changes to the rights attached to a class or group of members
- Having one class of members (or a closed membership structure) can help to simplify by-law and governance

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3. Avoiding Complexity of Proxy Voting Under the CNCA

- The CNCA sets out various methods for absentee voting, where a member may vote at a meeting without attending the meeting in person or electronically
- Some NFPs may be inclined to permit members to vote by proxy
 - Given that the CNCA and the regulations contain very detailed rules that apply, NFPs may wish to reconsider inclusion of proxy voting rights for members if an NFP lacks the infrastructure to comply with the highly complicated requirements that apply



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4. Appointment of Directors by Board

- As an optional provision, the CNCA states that the board may appoint directors between annual meetings, provided there is a clause in the articles authorizing the directors to do so
 - The number of appointed directors must not exceed one third of the directors elected at the previous annual meeting of members ("AGM")
 - The appointed directors can only hold office until the close of the next AGM
- Where an NFP has director terms that are 2 or 3 years, including a clause in the articles permitting the board to appoint up to one third of the directors can result in confusion since the appointed directors can only serve until the close of the next AGM

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F. SPECIFIC DRAFTING “PITFALLS” UNDER THE OCA

- Only limited comments are provided regarding pitfalls that can commonly occur with respect to by-laws for Ontario corporations established under the OCA at this time, since the OCA is expected to be replaced by the ONCA in the next few years
- All OCA corporations are required to have a by-law. However, many OCA corporations do not have a general operating by-law at all
 - This inadvertent omission might occur because there is no repository for OCA corporations to file a by-law with the Ontario Ministry of Government Services after incorporation
 - In contrast, under the CNCA, federal corporations are required to file by-laws within 12 months after the members have confirmed them

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- Unlike federal corporations established under the CNCA, OCA corporations are required to have a fixed number of directors
 - A number of OCA corporations have bylaws that reflect a range in the number of directors, which is not permitted
- Proxy voting rights for members is mandatory under the OCA
 - This is commonly omitted from the bylaws of OCA corporations giving the impression that proxy voting is not permitted

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