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## THE IMPORTANCE OF CORPORATE DOCUMENTS IN GOVERNANCE DISPUTES

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<p><b>The Importance of Corporate Documents in Governance Disputes</b></p> <p><b>By Esther S.J. Oh, B.A., LL.B.</b> <a href="mailto:estheroh@carters.ca">estheroh@carters.ca</a> <b>1-877-942-0001</b></p> <p>© 2017 Carters Professional Corporation</p>	
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## A. INTRODUCTORY COMMENTS

- Charities and Non-Profit Organizations (“NPOs”) play an important role in Canadian society, including:
  - Faith Communities
  - Professional Associations
  - Health Service Providers
  - Animal Shelters and many others



- Charities and NPOs are collectively referred to as “Organizations” in this presentation
- Differences of opinion can lead to disagreements
- Disputes within charities and NPOs that escalate into legal action can divert valuable resources away from an Organization’s programs:
  - Time spent by employees and volunteer board members to address the situation
  - Resources spent on legal, accounting or other professional services that may be needed
- While it is not possible to avoid disagreements from occurring, clear corporate documents can help to avoid disputes regarding the interpretation of those documents

## B. DIFFERENT TYPES OF LEGAL STATUS

- Different types of Organizations:
  - 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* which is not yet in force (“ONCA”) or other provincial statute
  - Incorporation under special legislation or other statutes
- Different legal requirements apply to an Organization depending on the governing statute
- Unincorporated associations and charities established by trust are not covered in this presentation

## C. DIFFERENT TYPES OF TAX STATUS

- Registered charity under the *Income Tax Act* (“ITA”)
  - Requires registration process and approval by Canada Revenue Agency (“CRA”), Charities Directorate
  - Exempt from income tax
  - Can issue official donation receipts for tax purposes in exchange for gifts received
  - Failure to comply with CRA requirements can result in enforcement action by CRA. In that regard, charities should always be prepared for a CRA audit
  - Higher fiduciary duties for directors of registered charities



- Allegations involving misapplication of charitable assets or breach of fiduciary duties of directors of charities in Ontario can result in involvement of Ontario Public Guardian and Trustee (“OPGT”)
- Informative and helpful resource for directors of charities:
  - PowerPoint entitled “*Why Do Director’s Get Into Trouble?*” presented by Kenneth Goodman, the Public Guardian and Trustee for Ontario, at the 2017 Ottawa Region Charity and Not-for-Profit Law Seminar is available at: <http://www.carters.ca/pub/seminar/charity/2017/Why-Do-Directors.pdf>

- Non-Profit Organization
  - No registration process required to become an NPO
  - Exempt from income tax
  - Cannot issue official donation receipts for tax purposes
  - Not subject to jurisdiction of Charities Directorate at CRA or OPGT
- Both charities and NPOs are required to use their resources to carry out programs that further the purposes of their Organization



## D. TYPES OF GOVERNANCE DISPUTES THAT CAN OCCUR

- Disagreements at a charity or NPO can occur at different levels:
  - Director vs. Director
  - Member vs. Board of Directors
  - Member vs. Member
  - Third party (i.e. someone outside of the Organization such as a donor) vs. Board of Directors
- Disputes can also occur between Organizations, e.g. affiliate Organization vs. parent Organization
- This presentation focuses on disputes between members and directors as they can commonly lead to litigation

## E. STEPS TO AVOID DISAGREEMENTS INVOLVING CORPORATE AND GOVERNANCE MATTERS

- When preparing for a board or membership meeting, it is important to follow correct procedures in accordance with the Organization's by-laws and policies, as well as the applicable corporate statute
  - This can help to insulate decisions made at the meeting from legal challenge



## 1. Importance of Following Correct Procedures at Board and Membership Meetings

- Where someone wishes to challenge a particular decision made at a board or membership meeting, the decision can be indirectly challenged on technical or procedural grounds
- For example, in order to challenge a decision made at a membership meeting, opposing counsel could allege that proper notice of the meeting was not given and therefore decisions made at the meeting are invalid



- In the context of a legal dispute, opposing legal counsel will review the corporate documents of an Organization, including the letters patent or articles as applicable, the by-law and policies, with the following questions in mind:
  - Do the documents reflect applicable legal requirements?
  - Were the documents properly adopted?
  - Were the procedures outlined in the documents followed?



## 2. Issues Within Corporate Documents That Organizations May Proactively Consider

- For purposes of this presentation, “corporate documents” refers to the letters patent or articles, as applicable, by-laws and policies of an Organization
- Corporate documents that are clearly drafted (i.e. self-explanatory), up-to-date and consistent with legal requirements can help to avoid disputes regarding those corporate documents
- The following slides provide a list of issues to guide Organizations as they review their corporate documents (although the list is not an exhaustive one)

- Do the purposes encompass the current activities of the Organization? (or has “mission drift” occurred since incorporation)
  - In the context of a legal dispute, Ontario corporations incorporated under the OCA that carry on activities outside its corporate authority may expose directors to liability for *ultra vires* activities, i.e. activities outside its corporate powers





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- Is the Organization operating in accordance with its current general operating by-law?
  - Sometimes an unincorporated association will operate in accordance with its constitution, then incorporate several years later
  - A new general operating by-law is required upon incorporation; the constitution used by the unincorporated association should not be used by the incorporated successor as different legal requirements apply
- Does the Organization's by-law reflect legal requirements under the applicable corporate statute?
  - i.e. federal corporations are governed by the CNCA and Ontario corporations are governed by the OCA, (pending the coming into force of the ONCA)

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- Are membership qualifications accurately described in the Organization's by-law?
  - By-law should stipulate that members must agree in writing to the purposes and the governing documents of the Organization
  - This can help to filter out individuals who are diametrically opposed to the purposes of the Organization from flooding the Organization's membership and electing new board members in an effort to change the direction of the Organization



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- All applications for membership should be subject to approval by the board of directors
- Some Organizations have one-year terms for members and require annual membership fees to be paid
  - In that case, the by-law should clearly indicate when membership term begins and ends each year
  - The by-law should clearly indicate the deadline by which annual membership fees must be paid in order to preserve voting rights at a membership meeting
  - Lack of clarity on the above issues can result in confusion and disagreements regarding which members are entitled to vote at a membership meeting

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- Do the corporate documents for the Organization reflect consistency with each other?
- Are there inconsistencies between the letters patent and/or articles, by-laws and policies?
  - e.g. Do the by-laws contain purposes that are different from the purposes in the letters patent or articles of the Organization
    - In the event of inconsistency the purposes in the letters patent or articles will prevail
  - e.g. Are conflict of interest (“COI”) provisions within a board policy consistent with the COI provision in the by-law
    - In the event of inconsistency the COI provisions in the by-law will prevail

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- Are the procedures outlined in the by-law or policies clear and are they consistently followed?
  - If not, this can expose the Organization to criticism for not following its own procedures



- Does the by-law contain a discipline procedure?
  - If yes, the discipline procedure should reflect principles of natural justice, which includes the following (which is not a comprehensive list):
    - Written summary of allegations should be provided to the individual under discipline
    - Explanation of the discipline process should be provided to the individual under discipline
    - Opportunity to respond to the allegations made against him or her
    - Sufficient notice should be provided to the individual in advance of any hearing
    - Written reasons for the Organization's decision on the discipline should be provided

- Where a member is removed from membership using a procedure that does not reflect natural justice, the removal can be legally challenged
- Given the complexity of this area of law and the potential liability risks involved to an Organization and its board, it is recommended that legal counsel be consulted prior to commencing any disciplinary action
- Additional comments on this topic will be provided later in the presentation when reviewing case law



### 3. Consider Establishing Closed Membership

- Enhanced rights are given to members under the CNCA and the ONCA
  - ONCA is not yet in force, and is not expected to come into force until late 2019 or early 2020 at the earliest
- Both the CNCA and the ONCA are conceptually structured on a business corporate model which gives enhanced rights of members
  - i.e. member rights are similar in many respects to rights of shareholders



## a) Brief Summary Of Members' Remedies Under CNCA and ONCA

- The following slides provide a few examples of the enhanced rights given to members under the CNCA and the ONCA
- CNCA
  - Right to seek an oppression remedy against the corporation where an act or omission of the corporation is oppressive, unfairly prejudicial or unfairly disregards the interests of a member
  - Right to seek a court order to commence a derivative action on behalf of the corporation
  - Restraining orders against the corporation, directors or officers

- ONCA
  - Compliance Order - where a corporation, or its directors and officers, fails to comply with the duties set out in the ONCA and regulations, the articles or by-laws
  - Rectification Order - if the name of a person has been wrongfully entered, retained, deleted or omitted from the registers or records of a corporation, that person may apply to a Court for an order rectifying the registers or records



- Derivative Action - gives members the right to bring an action in the name of the corporation (except religious corporations) to enforce one of its rights
- In light of enhanced rights given to members under CNCA and ONCA (yet to be proclaimed in force), Organizations may wish to consider establishing a closed membership corporation i.e. whereby the directors and members are composed of the same individuals
- Non-members involved in the Organization can be described using a different term:
  - “friends of”
  - “supporters”
  - “adherents” or
  - other terms



#### 4. Transparency and Collaboration with Membership When Making Important Decisions

- For open membership corporations, appropriate communication and consultation can be done with members prior to making a significant change
  - e.g. changes to corporate documents. While the following slides refer to the example of amendments to corporate documents, the suggestions can also be used for other decisions
- A collaborative process with members to invite questions and feedback prior to implementing a decision can help to avoid potential confusion which can lead to disputes
  - Also demonstrates transparency and can help to increase trust and support from the members

- The following slides reflect suggestions that may be useful for an Organization, subject to its particular circumstances
- Each Organization and each situation is different and therefore legal counsel should be consulted where guidance is required
- a) **Option of Holding a Town Hall Meeting**
  - Where changes to the letters patent/ articles or by-law will be made the board can prepare draft documents, which can then be presented to the membership for feedback and questions
  - In order to reflect legal requirements, legal assistance should be sought in the drafting process given the complexity of the CNCA and ONCA

- A Town Hall meeting or information session can be scheduled in order to explain the board's rationale for the changes being made and also to answer questions from the members
- No membership vote would be taken at the Town Hall meeting
- The draft corporate documents should be provided to members at least a few weeks in advance of the Town Hall meeting
- Members could be requested to submit their questions by a certain date, in advance of the Town Hall meeting



- After the Town Hall meeting the board can determine which changes will be included in the revised corporate documents in accordance with membership feedback
- Tracked copies of the revised corporate documents can then be provided to the members in advance of the membership meeting where the vote will be taken
- This process can help the board to gauge the support of the members and proactively identify potential areas of concerns from the membership in advance of the vote being taken at a membership meeting



## **b) Establish a Committee of Members and Directors**

- Where an Organization wishes to encourage direct membership involvement in the drafting process, the board could establish a committee composed of members and directors who would work together in preparing the new corporate documents
- The drafts prepared by the committee would first be presented to the board for approval, prior to distribution to the members
  - A Town Hall meeting could then be called as described in the previous slides
- In order to provide for an orderly process, it is important for the board to provide leadership in establishing appropriate parameters to guide the Town Hall meeting and committee at all stages



## c) Informal Consultations with Members

- In some situations it may not be practical for an Organization to hold a Town Hall meeting or establish a committee composed of directors and members
- In that case, the board can carry out informal consultations with members to determine whether required membership approvals can realistically be achieved at the meeting when the vote is taken
  - If not, as a practical measure a membership meeting should not be called until the board is confident that the necessary approvals can be obtained
  - Legal counsel can be sought to ensure applicable legal requirements are met while drafting of the corporate documents and in obtaining membership approvals

## F. BRIEF REVIEW OF CASE LAW

- The following cases illustrate the importance of having complete corporate records and following correct procedures in the event of a legal dispute
  - ***Colgan v. Canada's National Firearms Association 2016 ABQB 412 (CanLII)***
    - Decision of the Court of Queen's Bench in Alberta involving disputes between two factions on the board of directors of a corporation governed by the CNCA
    - In this case the Court addressed several fact-specific questions under the CNCA
    - In reviewing whether the Court should intervene in the Club's affairs, the Court stated:
      - "[C]ourts do not intervene in a club's affairs unless the club is guilty of breaching its rules or the rules of natural justice, or if there is bad faith in decision-making."

- “Courts have no interest in the day-to-day activities of voluntary associations” and “[t]hat certainly includes internal politics and inter-factional sniping.”

**Lesson to be learned:**

- The above statements from the Court confirmed previous case law reflecting reluctance of the Courts to intervene in disagreements of a charity or NPO, unless:
  - The Organization did not follow its own procedures as outlined in its own general operating by-law and policies, or
  - The Organization did not adhere to principles of natural justice, where disciplinary proceedings were carried out

**Rexdale Singh Sabha Religious Centre v. Chatta 2006 ONCA 39456 (CanLII)**

- Ontario Court of Appeal decision involving review of various areas of non-compliance with the requirements of the Ontario *Corporations Act*
  - The centre had never adopted a by-law after its incorporation in 1993
  - As a result the Court found the only directors and members were the incorporators

**Lesson to be learned:**

- This case underscores the importance of adopting a general operating by-law after incorporation



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***Nigerians in Diaspora Organization Canada (NIDO) v. Peter Ozemoyah 2011 ONSC 4696 (CanLII)***

- No new members were ever admitted to a federal corporation yet certain individuals (other than the incorporators) called a meeting and purported to elect a new board
- Since the election and composition of the board was governed by *Canada Corporations Act* and the general operating by-laws of the corporation only the first incorporators were valid directors

***Lesson to be learned:***

- In the context of a dispute, historical omissions in corporate records can result in vulnerabilities to the authority of the board
  - This case was decided under the CCA but has been referred to in subsequent cases, on different issues involving CNCA corporations

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***Wall v. Judicial Committee for the Congregation of Jehovah's Witness 2016 ABCA 255 (CanLII)***

- Alberta Court of Appeal affirmed Courts have jurisdiction to review discipline or expulsion by a religious organization where the expulsion did not reflect principles of natural justice
- See slide 20 for elements of natural justice, a number of which the Court found were absent in Wall
- Leave to appeal to the Supreme Court of Canada was granted on April 13, 2017

***Facts***

- Mr. Wall was provided a brief letter from his Congregation requesting he attend a meeting
  - Letter only stated his “alleged wrong doing involved drunkenness” and provided the logistical details for the meeting

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- After the meeting, Mr. Wall was “dis-fellowshipped” from Congregation
  - Congregation’s Judicial Committee determined he was not sufficiently repentant of his wrongdoing
- Mr. Wall appealed the decision to Appeal Committee of the Congregation and the Watch Tower and Bible Society of Canada who upheld the original decision of the Congregation’s Judicial Committee
- Mr. Wall was a Jehovah’s Witness since 1980 and was a realtor. After he was dis-fellowshipped, all other Jehovah’s Witnesses, including his family and a significant number of his clients were required to “shun” him

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- The Court noted Wall’s dis-fellowshipping from the Jehovah’s Witnesses resulted in alienation from his family and significant loss of clientele from his real estate business

***Lessons to be learned:***

- Discipline procedures must reflect natural justice
- Where the outcome of discipline will have a significant impact on an individual’s personal or business affairs, greater care must be taken to be fair to the individual under discipline

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***Singh v. Sandhu 2013 ONSC 3230, 2013 CarswellOnt 7398, 16 B.L.R. (5th) 194, 229 A.C.W.S. (3d) 22***

Justice Brown said the following in the above case:

*“It is not the policy of the Corporations Act that Courts should baby-sit the affairs of such corporations; self-governance by the members is the operating norm. If members, such as those of the [Centre], are incapable of governing the corporation, they should take a hard look in their collective mirrors and do one of three things: (i) reform their ways, which the current members seem incapable of doing; (ii) step aside and let new members who are unencumbered with the baggage of past factionalism take over the running of the corporation; or, (iii) wind-up the corporation, with the different factions parting company and setting up their own temples.”*

In commenting on Justice Brown’s statement in the *Singh v. Sandhu* case, the Office of the Ontario Public Guardian and Trustee said the following in its PowerPoint entitled “Why Do Director’s Get Into Trouble?”

*“There was no winner in this litigation. However, there was a loser - the Centre, because it’s directors were not prepared to put the corporation’s best interests before their own factional purposes”*



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