

ONTARIO DIVISIONAL COURT UPDATE ON FAIR AND REASONABLE INTERPRETATION OF BY-LAWS

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A. INTRODUCTION

This *Charity Law Bulletin* is a follow-up to *Charity Law Bulletin* No. 110 entitled *Non-Share Capital Corporations Must Interpret By-Laws Fairly, Reasonably and in Good Faith*, dated February 21, 2007.¹

B. BACKGROUND

Chu v. Scarborough Hospital Corp.,² a decision released by the Ontario Superior Court of Justice on December 28, 2006, involved a dispute between Lai Chu (“Ms. Chu”), an annual member of the Scarborough Hospital (the “Hospital”), and the Hospital’s board of directors (the “Board”). The decision of Justice David Brown canvassed a number of provisions of the *Corporations Act* (Ontario) (the “Act”),³ the statute under which many Ontario charitable and not-for-profit organizations incorporate. The interpretation of by-laws, the calling of special meetings, classes and terms of membership, and the Hospital’s governance structure were all considered in the trial decision. In granting Ms. Chu’s application, an order was made for the Hospital’s membership to run for a full twelve months and for the Board to call a general meeting of the Hospital’s membership, to be held no later than January 31, 2007.

¹ Terrance S. Carter and Paula J. Thomas, online: <http://www.carters.ca/pub/bulletin/charity/2007/chylb110.pdf>.

² [2006] O.J. No. 5147.

³ R.S.O. 1990, c. C.38.

The Hospital appealed the order to the Ontario Divisional Court (the “Divisional Court”) pursuant to section 329 of the Act and requested that the order be set aside. The appeal was heard on March 26, 2007 and the decision was released on July 7, 2007.

The appellant’s position was that Justice Brown had “erred with respect to his application and interpretation of the relevant provisions of the [Act] and the Hospital’s by-laws.”⁴ In requesting that the Hospital’s appeal be dismissed, Ms. Chu took the position that Justice Brown had not, in fact, erred in his decision that the Board had acted unfairly toward its annual members, in concluding that the Board had misinterpreted its authority to appoint such members, or in deciding that it was not to unilaterally revise the Hospital’s by-laws.

C. STANDARD OF REVIEW

Both the Hospital and Ms. Chu agreed that the standard of review to be applied in the appeal was on the basis of either an error of law or to errors of mixed fact and law. The Hospital was of the view that the order was reviewable on a standard of correctness because the decision involved an error of law or an extricable error of mixed fact and law in interpreting the category of “annual membership” pursuant to the Act and the Hospital’s by-laws. In the alternative, counsel for the Hospital argued that the decision involved a palpable and overriding error in the interpretation of the Act and the by-laws, and in the application of the facts to the legal tests. However, the Divisional Court concurred with Ms. Chu’s view that the trial decision included questions of mixed fact and law which were not readily extricable from the questions of fact. In that regard, the Divisional Court concluded that the “[trial] decision involved a legal interpretation of the [Act] as well as the Hospital’s by-laws and the application of that interpretation to the very specific facts of this case ... and hence the standard of review [was] that of palpable and overriding error.”⁵

⁴ *Chu v. Scarborough Hospital Corp.*, Divisional Court File No. 009/07, Court File No. 06-CU-323276PD1, July 6, 2007 at para. 1.

⁵ *Ibid.*, at para. 6.

D. ONTARIO DIVISIONAL COURT DECISION

The appeal turned on whether Ms. Chu's request to the Board to call and hold a special meeting was valid. In that regard, the Divisional Court had to determine whether she was an approved annual member at the time she made the said request. At trial, it was held that she was, in fact, an approved annual member at that time, and as such her request for a special meeting was legitimate. The manner in which the Board had been interpreting the annual member class of membership caused a length of service of only four or five months. Both the trial judge and the Divisional Court agreed that this was not a correct interpretation of the by-laws and was, in fact, unfair and unreasonable. An annual membership should be exactly that: a membership which ran for a period of a full twelve months.

The Divisional Court quoted Justice Brown's sound admonishment of the Board's actions in noting paragraph 42 of the trial decision:

The Board has not acted fairly towards the Hospital's Approval Annual Members. It has construed its powers to appoint such members and to amend the Hospital's by-laws. In addition, the Board cannot on the one hand adopt a by-law amendment that by its very language created a reasonable expectation that Approved Annual Members would have meaningful input into the governance review process and resulting by-law amendments, and then dash those expectations by removing the item from the agenda and relying on a highly formalistic position that the memberships of the Approved Annual Members had evaporated. The evidence paints the picture of a Board interpreting the Hospital's by-laws in an unreasonable way that places complete control of governance matters in the hands of the directors and negates any meaningful role for Approved Annual Members.

The Divisional Court concluded that there was no palpable and overriding error in the trial judge's decision. While the Divisional Court agreed with the appellant's submission that the Act neither refers to "Annual Members" as a category of membership, nor mandates one which runs for a full year, a unilateral interpretation by the Board of this category of membership pursuant to the Hospital's by-laws was not reasonable. The Hospital's By-law No. 1 indicated that the role of the annual members was "to act as a check and balance to the powers of the Board of Directors" and as such it was "not reasonable that [the Board] should in its sole discretion be able to determine unilaterally the duration of such Memberships from year to year or from event to event."⁶ In the Divisional Court's view, the "annual membership" category had to be given "ordinary and plain language meaning, namely that such memberships would run for a full year."⁷

⁶ *Ibid.*, at para. 18.

⁷ *Ibid.*

Notwithstanding the dismissal of the appellant's appeal, the Divisional Court concurred with one of the Hospital's arguments, in that the case law plainly establishes the following:

[t]he by-laws of non-share capital corporations incorporated pursuant to the *Corporations Act*, like the case at bar, constitute contractual obligations as between the members and the corporation (see *Senez v. Montreal Real Estate Board*, [1980] 2 S.C.R. 555 (S.C.C.), QL p. 7 and *Sahayadakivski v. YMCA*, [2006] O.J. No. 1368 (S.C.J.), paras. 28-30). Both the corporation and individuals who become members of the corporation undertake to comply with the constating documents and the by-laws, which are duly adopted by a majority of members entitled to vote, even if they disagree with those by-laws.⁸

Furthermore, the Divisional Court also agreed that jurisprudence indicates that the courts are not to interfere with decisions made by a non-share capital corporation pursuant to its by-laws, provided that such decisions are not made in bad faith or in contravention of the rules of natural justice. However, in this case, the word "annual" had been interpreted by the Board in an unfair manner. At trial and on appeal, both courts agreed that "annual" means a full year of twelve months.

E. ONTARIO GOVERNMENT'S RESPONSE

Following the Divisional Court's ruling, the Ontario government acted swiftly in response to the ongoing struggle between the Hospital's board of directors and the community group led by Ms. Chu. The Ontario Minister of Health, George Smitherman (the "Minister of Health"), has put the Hospital on notice that he is requesting approval from the provincial legislature to appoint a supervisor who will assume control of the Hospital and report directly to the Minister of Health. While the appointment of a supervisor to help bring stability is an unusual step on the part of the provincial government, it has been initiated with the hope that the conflict will be lessened between the board of directors and the Scarborough community members who wish to have input into the Hospital's decision-making process.

F. CONCLUDING COMMENTS

The trial and appeal decisions in *Chu v. Scarborough Hospital Corp.* echo the growing trend in case law which insists that charitable and not-for-profit organizations comply with corporate governance procedures as set out in their governing statutes, constating documents and by-laws. It is essential that such compliance be conducted in a manner which is reasonable, fair and in good faith. Acting in accordance with such legislation and documentation will assist in preventing, or at least moderating, disputes among those involved with

⁸ *Supra* note 5 at para. 20.

governance matters. Furthermore, the court decisions indicate that control over such governance procedures is to be shared among the directors, officers and voting members, not centred in the hands of a few people acting on their own accord. In this regard, the Divisional Court has reaffirmed earlier case law that a corporation, as well as the individuals who become members, which would include directors, have entered into an implicit contractual obligation to comply with the constating documents and by-laws of the corporation.