
ONTARIO REPORT ON DUAL PURPOSE CORPORATE LEGISLATION

*By Terrance S. Carter**

A. INTRODUCTION

The Ontario Report on “Dual Purpose Corporate Structure Legislation” (the “Report”) that was prepared by a panel of sector representatives¹ in early 2014 (the “Panel”), was finally released by the Ministry of Government and Consumer Services on January 29, 2015.² The Report contains two main sections, a very helpful description of social enterprise, as well as a review of the panel’s recommendations for implementing dual purpose corporate legislation in Ontario. The Ontario Ministry of Government and Consumer Services is currently seeking public feedback on the Report until May 4, 2015. This *Charity Law Bulletin* outlines how the Report effectively explains social enterprise and provides an overview of the recommendations in the Report.

B. THE SOCIAL ENTERPRISE INITIATIVE

In Ontario, the Ministry of Government and Consumer Services (the “Ministry”) is working with the Ministry of Economic Development, Trade and Employment to explore the potential for new dual purpose corporate legislation to serve the needs of social enterprises. Dual purpose corporate legislation in general refers to legislation that addresses both the social interest of a corporation and its ability to make a profit. A review of dual purpose corporate legislation is part of the Ministry’s mandate to

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¹ The author was a member of the panel of sector representatives, whose recommendations form the content of the Report.

² *Dual Purpose Corporate Structure Legislation: Stakeholder Engagement Report*, prepared on behalf of the Social Enterprise Panel by Deloitte (May 2014), online at: <goo.gl/ZjpHus>.

modernize the province's business laws. The initiative to look at social enterprise in Ontario follows the development of dual purpose corporate legislation in British Columbia,³ Nova Scotia⁴ and the United Kingdom.⁵ As a first step in the process of introducing such legislation in Ontario, the Ministry brought together fourteen "stakeholders," who have experience and expertise in social enterprise, to consider how potential legislation could effectively allow corporations to pursue a social purpose while, at the same time, pursue a private, for-profit interest.

C. WHAT IS SOCIAL ENTERPRISE?

The Report describes a social enterprise as a "corporate entity that exists primarily to promote public benefit ... [and] uses business strategies to maximize social impact, build social and financial capital, and offer innovative ways of operating for social and/or environmental purposes."⁶

1. Scope of Social Enterprise in Ontario

Although the Report focuses on for-profit social purpose businesses, it is important to understand that social enterprises can take many forms. For example, social enterprises can take the form of associations, sole proprietorships, partnerships, cooperatives or corporations, in addition to traditional charities and not-for-profits. Further, social enterprises can have a range of social purposes, including health, cultural, educational and environmental.

In addition to becoming more diverse, the report found that the number of social enterprises in Ontario is also increasing. For example, in 2013, the government's Social Enterprise Strategy estimated that there were over 10,000 social enterprises already operating in Ontario.⁷ However, despite the increasing size of the sector, in Ontario there is currently no corporate structure that specifically enables a dual purpose social enterprise. Such enterprises currently need to exist under the *Business Corporations Act* ("OBCA"), the *Corporations Act* ("OCA"), which will be replaced

³ Part 2.2 of the British Columbia *Business Corporations Act*, [SBC 2002] Chapter 57, includes provisions which allow for "Community Contribution Companies." This corporate option became available for use in July 2013.

⁴ In 2012, Nova Scotia passed the Community Interest Corporation designation into law through the *Community Interest Companies Act*, CHAPTER 38 of the Acts of 2012. The legislation is not yet in force.

⁵ Community Interest Companies can be registered in England and Wales, Scotland or Northern Ireland through the *Companies (Audit, Investigations and Community Enterprise) Act*, 2004 c7.

⁶ *Supra* note 2 at 4.

⁷ *Impact: A Social Enterprise Strategy for Ontario* (Queen's Printer for Ontario, 2013), , online: <<https://dr6j45jk9xcmk.cloudfront.net/documents/697/impact-socialenterprise.pdf>> 5.

by the *Not-for-Profit Corporations Act* (“ONCA”), and the *Co-operative Corporations Act* (“CCA”). While each of these acts address some needs of social enterprises, none of them fully address how to merge a social mission with a for-profit structure. As a result, the Report indicated that it is increasingly important to consider how new legislation might be able to effectively govern this emerging sector.

2. Challenges Facing Social Enterprise

Given the absence of legislation that effectively addresses the needs of social enterprises, those organizations face a number of challenges. For example, under the OCA or the new ONCA, not-for-profits cannot issue shares or distribute dividends, and, therefore, cannot attract equity investment. Alternatively, for-profit corporations may not be able to assure social investors that their investments will be used for social purposes, since directors must act in the corporation’s best interests, which often prioritize a financial return ahead of a social purpose. Developing dual purpose or hybrid legislation could help address these challenges and others in a variety of ways, including enshrining the social purpose into a corporation’s articles and facilitating a founder’s access to equity. Additionally, developing new hybrid legislation would result in a more cohesive set of rules and expectations for all social enterprises in Ontario, which would be an improvement over the current fractured approach created by using different pieces of legislation.

D. POTENTIAL FRAMEWORK FOR NEW LEGISLATION

When developing its recommendations, the Panel considered the interests of many stakeholders, including social entrepreneurs, investors and funders, employees, and consumers, which ranged from ensuring that investments are targeted to a stated social purpose to ensuring that enterprises are able to provide satisfactory returns. In response, the Panel developed a legislative framework that groups issues into key topics and draws links between the areas. This structure includes:

1. mixed social purpose and private interest;
2. distribution constraints;
3. corporate governance;
4. reporting requirements; and
5. oversight.⁸

⁸ *Supra* note 2 at 9.

The Panel also emphasized that any future legislation would have to “strike a balance between providing appropriate flexibility and scope” while ensuring that “suitable boundaries [exist] to protect the social purpose and ensure effective governance.”⁹

1. Mixed social purpose and private interest

Combining a defined social purpose with a private financial interest is the key feature of a social enterprise. The Panel considered how a corporation should specify its social purpose, specifically whether the social purpose should be integral to the corporation’s activities or whether only the profits should be dedicated to the social purpose. The Report discusses how a more flexible definition would allow for more innovation, but could potentially create more room for abuse if the focus of the corporation remains predominately on profit making. A regulator could be involved in assessing the corporation’s social purpose. Doing so could be done with either a “reasonable person standard” or a “bright line test.” The Panel stated that while a “bright line test” would provide more certainty, it could also limit innovation if the definition of social purpose is set too narrowly.

The Panel recommended that any proposed legislation should require an organization to have a statement of social purpose in its articles that would include the activities being pursued and the outcomes sought. The Panel also recommended that the legislation should use a “reasonable person test” and should also include a process to allow the definition of social purpose to be modified as required. Finally, the Panel also discussed how to stem potential abuse of social purpose. The majority of panel members recommended that it be “destined or dedicated to a social purpose with oversight provided by a regulator,” while a minority of panellists thought that business activities should be made integral to the social purpose.¹⁰

2. Distribution Constraints

Distribution constraints are intended to ensure that revenue, assets and profits are appropriately allocated to the social purpose and the private financial interest.¹¹ The Panel recommended that dual purpose legislation should establish distribution constraints on assets and profits. These

⁹ *Ibid* at 10.

¹⁰ *Ibid* at 11.

¹¹ *Ibid* at 11.

constraints would serve to protect the social purpose of an organization while also allowing the organization to share some profit with investors. The Report discussed percentage based distribution constraints and flexible distribution constraints. The existing legislation in British Columbia and Nova Scotia both use a percentage based system. Harmonization of legislation across Canada would be one of the main points in favour of adopting such a system. It is also relatively straightforward and easier to administer than a flexible system.

3. Corporate Governance

The Panel further emphasized the importance of internal accountability, which includes both director roles and responsibilities and shareholder rights.

a) Director Roles and Responsibilities

The Panel stated that any proposed legislation should, at a minimum, impose the same standards and duties on directors as is done in the OBCA, including the requirement for a minimum of three directors. It also concluded that instead of having an independent director whose sole purpose is to represent the corporation's social purpose, it is better practice to require each director to consider all of the purposes of the corporation, including the social purpose, when acting in its best interests. Further, the Report highlighted that directors should be responsible for approving a mandatory annual social benefit report.

b) Shareholder Rights

The Panel considered shareholder rights and concluded that, in order to protect the corporation's social purpose, a two-thirds shareholder approval should be required for any fundamental changes, such as changing the social purposes of the corporation. The Panel rejected the idea that social enterprises should be required to have a minimum number of shareholders because it was concerned that doing so would create unnecessary restrictions, particularly in the early stages of corporate development.

4. Reporting Requirements

In the social enterprise field, publically-available annual reporting in the form of a "social benefit report" is frequently used as a means to describe an organization's social purposes or the activities it pursues to benefit society. The Panel members had mixed views on whether a more general

description of an organization's social purpose activities or an independent "third-party" assessment would be more beneficial. It did not make a final conclusion on this point. The Panel members also held mixed views on whether the disclosure of basic information should be determined by the corporation or supported by an independent body. The majority believed that an annual report should be completed by the corporation with the directors responsible to the shareholders for its content. The Panel did, however, agree that, at a minimum, approved financial statements should be provided to the shareholders and the social benefit report should include enough financial information to demonstrate that the social purpose is being achieved. Finally, the Panel emphasized that requirements regarding financial statements should be dependent on the size of the organization so as to achieve administrative proportionality.

5. Oversight

Finally, the Panel also discussed the potential role of a regulator in reviewing, monitoring, and investigating social enterprises. For example, a regulator could have a role in assessing a corporation's social purpose. The Panel concluded that any dual purpose legislation should, at a minimum, include the same regulatory functions, duties, and powers as the Director under the OBCA. It also recommended including a simple regulatory framework that could provide flexibility, while retaining the ability to introduce more detailed regulation if doing so is required in the future. The Panel thought that this type of supportive approach would provide effective oversight while helping to build the sector without impeding investment.

E. CONCLUSION

While social enterprise remains a relatively new and emerging field, the Report demonstrates how dedicated dual purpose legislation could effectively address the needs of the sector. Although the Report focuses on for-profit social enterprises, it also states that the government should support all forms of social enterprise, including for not-for-profits and charities, and that any proposed legislation should complement existing legislation. Similarly, the Report also recommends that any new legislation should allow social enterprises to incorporate under the legislation to which they are best suited. Finally, the Panel repeatedly emphasized that any new legislation would be just one part of a successful multi-prong approach to making Ontario a leader in the social enterprise field.

The Report is a welcome addition to the growing discussion about social enterprise in Ontario. Hopefully, it will be an effective first step in enabling the Ontario government to move forward in engaging with and effectively addressing the needs of social enterprises in Ontario.