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CNCA 10 Years In: Lessons Learned and Pitfalls to Avoid

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WHAT ARE WE DOING TODAY?

- *Canada Not-for-profit Corporations Act* (“CNCA”) has been around since 2011
- This presentation reviews
 - Background of the CNCA
 - How the sector received the CNCA?
 - CNCA continuance issues
 - What can be improved?
 - COVID-19 issues
 - Going forward?

A. HOW DID WE GET HERE?

- *Canada Corporations Act* (“CCA”) since 1917
 - Part II governed non-share capital corporations
 - Part III governed non-share capital federal statutory corporations
- CNCA enacted to replace Part II and Part III of CCA
- Enacted on June 23, 2009, in force on October 17, 2011
- Federal statutory corporations automatically governed under Part 19 of CNCA when CNCA came into force

- All Part II CCA corporations were required to continue under the CNCA within 3 years (i.e., by October 17, 2014), failure to do so would result in dissolution
- There were approximately 17,000 Part II CCA corporations in 2011
- By Dec 31, 2017, all Part II CCA corporations were either transitioned to CNCA or dissolved
- Regulations under the CCA were repealed on Dec 30, 2017
- Remaining provisions in the CCA were repealed on Dec 31, 2017

B. HOW DID THE SECTOR RECEIVE IT?

What has the sector learned in the 10 years living with the CNCA?

- Pros
 - Modern legislation, modelled after CBCA
 - Provides default rules to fill in gaps in by-laws
- Cons
 - Irrelevant to the sector and does not meet the needs and expectations of the sector in many respects
 - Overly prescriptive

- Created counterpart of each CBCA provision, instead of skipping or modifying those CBCA provisions that do not reflect the culture, tradition and operations of the sector
- Complex rules to learn, huge learning curve
 - Does not reflect the high turnover rate of directors, officers, members, and staff of the sector, difficult to retain corporate memory
 - New learning required whenever there is a change

- Result
 - Sector did not embrace all of the rules in the CNCA
 - In order to continue to reflect the culture of the sector, there were extensive considerations on workarounds to mitigate those rules that are considered objectionable and overly restrictive
 - Preference to incorporate provincially where possible, subject to being able to achieve other goals

- For example - the sector needs and embraces the involvement and support of community stakeholders
 - Tradition – involve them as non-voting members in the corporation
 - CNCA concerns – non-voting members have mandatory class vote and class veto powers on certain decisions (generally undesirable for the sector)
 - CNCA workaround – change them into non-membership categories, such as “affiliates”, “associates”, “supporters”, “adherents”
 - Effect – lose engagement of stakeholders

C. OBSERVATION OF CNCA CONTINUANCE ISSUES

- Problematic examples of what corporations did when continued from CCA to CNCA
- Many of these can also arise for new incorporations
- Encouraging the sector to draft their own by-laws is an ideal that is not practical and is fraught with problems

Examples:

- Continued to use old CCA bylaws for CNCA
- Continued to retain old CCA provisions - e.g., 2/3 vote of the directors to remove a director (CNCA requires simple majority of the votes cast by the members), or how to give notice for members' meetings

- Revised purposes in articles of continuance but did not give them to CRA for approval
- Revised purposes in articles, but gave different documents to CRA for approval
- Description of membership classes and rights in the articles contains too much information, such as membership qualification requirements, membership terms, dues

- Used Corporations Canada’s “model by-laws” on their website without customizing it to fit the characteristics of the corporation
 - For example – retained the reference to Class A voting members and Class B non-voting members in the model by-laws when this has no correlation to the actual membership

- Inconsistent description of membership classes and rights in the articles vs bylaws, for example:
 - Class A and Class B in articles has no correlation to membership provisions in the by-law
 - Articles provide for Class A and Class B members, then the by-law has brief reference to Class A and Class B, but also have separate section on “membership” classes for regular members, youth members, non-voting retired members

- Inconsistent by-laws and policies
 - Upon continuance into CNCA, collapsed membership classes into one class (to avoid class vote rights), but optional policy continues to provide for pre-continuance multiple membership class structure
 - Moved non-voting membership class out of membership upon continuance into CNCA, but operationally still maintain non-voting membership class

- Continued to use simple proxy form under the former CCA, but does not comply with the requirements in the Regulations
- CNCA continuance changed how and when AGMs are called and held, but corporation continued to operate in the old CCA rules
- Not knowing there is a requirement to file Form 4006 when there is change of directors (continued to think that directors changes are only to be filed in annual return, as in the CCA rules)
- Not knowing there is a requirement to file by-laws with Corporations Canada

D. WHAT CAN BE IMPROVED?

- Many CNCA rules are difficult for the sector to understand or comply with
- Many CNCA rules do not reflect sector practice
- This section gives examples of key issues and suggestions on how to improve them
- Many of these are referred to in Canadian Bar Association's submission to Corporations Canada on the CNCA in Dec. 2019 made 19 recommendations

<https://www.cba.org/CMSPages/GetFile.aspx?guid=a99e1a99-8a8f-40cf-b5ef-82b68eb600c0>

1. Rules Difficult for the Sector to Understand or Comply With

(a) Soliciting Status

- Difficult to understand - 3 year rolling status and what would be included in the \$10,000 threshold
- CNCA requires that all corporations categorized into soliciting and non-soliciting corporations
 - If a corporation receives more than \$10,000 in its last financial period from public sources, it will become a soliciting corporation
 - 3 year status - from the AGM in the following financial year until the 3rd AGM

- Public sources
 - (a) requests for donations or gifts from persons who are not
 - members, directors, officers, or employees of the corporation at the time of the request
 - legal or common law spouse of the above persons
 - children, parents, brothers, sisters, grandparents, uncles, aunts, nephews or nieces of the above persons
 - (b) grants or other similar financial assistance received from the federal or a provincial or a municipal government, or agencies of such government
 - (c) donations or gifts received from a soliciting corporation

- Implications of being a soliciting corporation
 - Must have at least 3 directors, at least 2 directors must not be officers or employees of the corporation or its affiliates
 - Articles must provide for the distribution of remaining property on dissolution to qualified donees
 - No unanimous member agreement
 - Must file annual financial statements with Corporations Canada
 - Audit and public accountant rules more stringent

- Easy to move in and out of soliciting status because of low \$10,000 threshold, requires corporations to have constant monitoring of funding sources and quantum
- Rationale for different financial levels for the appointment of a public accountant and the level of financial review between soliciting and non-soliciting corporations does not appear justified in practice

- Wish list
 - Remove mandatory audit, let members decide to require audit or review engagement, either at a meeting or through by-laws
 - Remove distinction between soliciting and non-soliciting corporations for accounting purposes and prescribed revenue limits for dispensing with a public accountant be the same for both

(b) Proxy Rules

- Detailed rules in the Regulations are complicated and highly prescriptive, difficult for the sector to understand or comply with the requirements, discourages corporations to use proxy vote
- Does not permit corporations to require proxyholders to be members – does not reflect sector practice
- Does not allow corporation to set a cut-off time for proxies to be deposited before a membership meeting

- Wish list
 - Simplify the proxy rules in the Regulations
 - Allow corporations to limit proxyholders to members
 - Allow corporations to set a cut-off time (e.g., 48 hours) for proxies to be deposited before a membership meeting

(c) Appointment of Directors

- Board can appoint up to 1/3 the number elected at the last AGM (not 1/3 of the entire board) for a one year term to expire at next AGM
- Calculation of the 1/3 rule is difficult to understand
- Wish list – simplify the rule, not tie the limit of appointment to the number of directors elected at the immediate last AGM, perhaps change to 1/3 (or a lower number) of directors in office

2. Rules that Do Not Reflect Sector Practice

(a) Prohibition of Ex Officio Directors or External Appointment

- Long tradition and common practice in the sector to provide for ex officio directors or have directors appointed by third parties
- Workaround – e.g., create dedicated board seat that only a person with special qualifications can be elected to that seat, or nomination requirement by third party
- Wish list – permit ex officio directors and third party appointments provided that the person consents to act

(b) Prohibition of Delegate Voting

- Long tradition in the sector to utilize delegate voting, such as religious denominations, professional organizations, national organizations with regional chapters and representations
- Used to be permitted by CCA
- Workaround – e.g., artificial structuring of membership framework, weighted voting
- Wish list – permit delegate voting and let by-laws set out how such voting would operate

(c) Mandatory Class Votes

- CNCA requires where there is more than 1 class, each class is entitled to separate class votes (regardless whether voting or non-voting) on two types of matters
 - Fundamental changes - amalgamation, continuance, sale of all or substantially all of the property of a corporation other than in the ordinary course of its activities
 - Changes of the rights attached to a class or group of members (with limited opt-out)
- A class of members could reject a change - effectively resulting in a class veto

- Treatment of members mirrors that in the CBCA for shareholder's rights, however members in most sector organizations do not have economic interests like shareholders have
- Many reasons to have multiple membership classes, e.g.
 - Members from different industry sectors
 - Members from different geographical regions, chapters, branches
 - Members from different age groups
 - Founders
 - Broad-based community support, donors
 - Honorary members, life members

- Workaround - artificial design of membership structure and voting rights
- Wish list
 - Permit opt in to class votes, not mandatory
 - Not give non-voting members mandatory voting powers except where they have economic interest to join the membership, permit opt in to limited voting rights

(d) Directors Must be Elected at AGMs

- CNCA requires directors must be elected at AGM
- Does not reflect sector practice, many organizations hold two membership meetings
 - One meeting to receive the financials with timing tied to financial year
 - Second meeting to elect directors and approve the budget with timing tied to operational cycle
- Workaround – artificial adjustment of term of directors or timing to hold the AGM
- Wish list - allow corporations to opt out to elect directors at other membership meetings or by other means

(e) Directors of Soliciting Corporations

- Soliciting corporations must have at least 3 directors, at least 2 directors must not be officers or employees of the corporation or its affiliates
- For small boards (such as 3 directors), this means that only 1 of the 3 directors can be an officer, but not the other 2 directors
- Workaround – have 1 director to have all 3 officer positions, may not be able to find non-directors to be officers
- Wish list – remove this requirement

(f) Nominations from the Floor

- CNCA allows members the right to nominate from the floor of AGMs
- Does not reflect the practice and tradition of the sector, defeats the role of nominations policy or process
- Attempted workarounds - Advance notice by-law provisions
- Wish list – permit corporations to opt-in instead of mandatory

3. Other Rules for Improvement

(a) Virtual Meetings

- Hybrid meetings – permitted by default unless opt out in the by-laws
- Virtual meeting – permitted only if provided for in the by-laws
- However, difficult for corporations to understand the difference
- Wish list – make both as default mechanisms, and corporations may opt out by by-laws

(b) Standalone Vote Outside of Meetings

- CNCA requires membership votes must be made in the context of membership meetings
- CNCA permits votes by electronic means
- Technology enabling a stand-alone vote is well established and reliable, and some corporations already conduct “referendum” style votes under permissive provisions of the by-laws
- Wish list – permit corporations to conduct, at the board’s discretion, a vote of members at any time, not in connection with a members’ meeting

(c) Tally of Votes

- CNCA requires votes at hybrid and virtual meetings and electronic voting be gathered in a manner that permits its subsequent verification and be tallied to be presented to “the corporation” without it being possible for “the corporation” to identify how the person voted
- *Both* anonymity and verification can only be achieved where anonymity is limited to the voters participating in the meeting or vote, not “the corporation”
- Wish list – only require votes tallied to be presented without it being possible for any member of the corporation to identify how each member voted

(d) Duty of Directors to Verify

- CNCA imposes on each director a duty to “verify the lawfulness of the articles and the purpose of the corporation
- This is not required in any other corporate legislation
- Wish list – remove the requirement

(e) Meaning of Ordinary Resolution

- CNCA defines “ordinary resolution” to mean “a resolution passed by a majority of the votes cast on that resolution”
- Corporations Canada’s by-law defines “ordinary resolution” to mean “a resolution passed by a majority of not less than 50% plus 1 of the votes cast on that resolution”
- However, simple majority vote is *not the same* as 50% plus 1

For example 10 members, 7 attended, 5 voted

- Simple majority of votes cast = 3
- 50% plus 1 = 4
 - 50% of 5 = 2.5
 - 2.5 + 1 = 3.5
 - Have to round up to 4 because you can not cut a person in half!

E. COVID-19 ISSUES?

- There are relief measures extending the deadline to file CRA and corporate returns because of COVID-19
- Charities and NFPs need to adjust how they hold board meetings and members' meetings during the COVID-19 pandemic because
 - Limit on how many people can gather
 - Physical distancing

- Directors' fiduciary duties to act in the best interest of the organization by balancing the need to comply with legal requirements against the need to protect the health and well-being of directors and members and not subject them to risk of virus infection
- See Charity and NFP Law Bulletin 466
<http://www.carters.ca/pub/bulletin/charity/2020/chylb466.pdf>

1. Corporate Filing Deadline

CNCA Corporations – Annual Returns due within 60 days after “anniversary date” (date the corporation incorporated, amalgamated or continued under CNCA)

| | |
|---|---|
| For corporations whose anniversary date is between February 1 and June 30, 2020 | Relief – filing deadline extended to September 30, 2020 |
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Federal Special Act Corporations – Annual Returns due between April 1 - June 1

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| All federal special act corporations (filing period April 1 to June 1, 2020) | Relief – filing period extended to the period of April 1 to September 30, 2020 |
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2. Board Meetings

- Directors may participate in a meeting of directors or of a committee of directors “by means of a telephonic, an electronic or other communication facility” if all of the following conditions are met: [s. 136(7)]
 - (1) If all the directors of the corporation consent
 - (2) The facility permits all participants to communicate adequately with each other during the meeting
 - (3) The by-law does not otherwise provide
- No relief from Corporations Canada

- How to hold virtual board meetings?
 - Similar issues to address as those for members' meetings
 - Generally easier to address meeting issues because of small number of participants, e.g., conference call, Skype, WhatsApp, Zoom

3. Members' Meetings (AGMs and Special Meetings)

- AGM must be held not later than 18 months after its incorporation and subsequently not more than 15 months after the previous AGM, but no later than 6 months after the financial year end [CNCA s. 160(1) and CNCR s. 61]
- Hold hybrid or virtual meeting

- Examples of common IT platforms for electronic meetings, pros and cons for each one
 - GetQuorum
 - GoToMeeting
 - Microsoft Teams
 - Zoom
 - Onstream Meetings
 - Broadbridge
 - ClickMeeting
 - Pragmatic
- May couple with voting platform, e.g., Election Buddy, Simple Survey, Simply Voting, Secured Voting

- No blanket relief from Corporations Canada
- May apply to Corporations Canada to extend the time for calling an AGM
 - New streamlined process due to COVID-19 released on May 11 for use from May 12
<https://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs06828.html>
 - Inconsistent instructions
 - Deadline to apply – 30 days before the day on which the notice of members meeting is given (30 business days on a different page)
 - Corporations with Dec 31, 2019 year end are already out of time to apply?

- Examples where desirable to delay the AGM
 - Not possible to adopt written resolutions in lieu of holding an AGM
 - Hybrid or virtual meetings cannot or not suitable to be held
 - Audited financial statements not ready because the audit is delayed due to COVID-19

- Creative DIY solutions and not to ask for order to delay AGM? – Cautions:
 - Directors and officers under the CNCA must comply with the CNCA and regulations under the CNCA, articles, by-laws, and unanimous member agreements
 - The date when the AGM is held has to be reported in the Annual Return

- Consequence of delaying the AGM
 - A director not elected for an expressly stated term ceases to hold office at the close of the first AGM following the director's election [s. 128(5)]
 - Appointed directors hold office for a term expiring not later than the close of the next AGM [s. 128(8)]
 - If directors are not elected at a meeting of members, the incumbent directors continue in office until their successors are elected [s. 128(6)]

F. WHAT NEXT?

- CNCA is modern legislation and provides default rules to fill in gaps
- Hope that many of the rules may be simplified, relaxed and revised to better fit the culture, tradition and operations of the sector, and meet their needs and expectation

Disclaimer

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QUESTIONS





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