For the Record

Three Views on Bill C-21: *Canada Not-For-Profit Corporations Act*

Editor's Introduction

The three briefs in this For the Record comment on Bill C-21, the proposed *Canada Not-for-Profit Corporations Act* introduced by the former Liberal Government. The Bill died with the election of the Conservatives to government in early 2006. The three briefs come at the Bill from different perspectives—two more critical of it than the third (prepared by the Editor of this journal).

What is disturbing is that all three briefs have a common element—the sector needs new legislation, and the failure of Parliament and governments for decades to provide it is an appalling situation. Too often the political arm of government says nice words about "the third sector" and its importance to the social, cultural, and even economic life of Canada and Canadians. Too often the nice words of the political arm of government are not fulfilled through improved levels of support or the provision of a rational and modern legal structure. Too often those who participate in the sector become sceptical of the nice words.

This situation has been created, in no small measure, by us—by those who participate in the sector and who provide legal, accounting, and other advice. We do not have our own act together at the federal or even provincial level. Politicians are risk averse when it comes to legislation with respect to the charitable and not-for-profit sector. They, understandably, do not want to be caught in the middle of different factions within the sector. They particularly want to avoid unnecessary political problems during minority governments.

Ontario has announced that it will reform the *Corporations Act*. The sector within Ontario should embrace the opportunity for reform but should do so around key approaches where consensus can be built. Without that consensus, this opportunity may disappear as it most recently did with Bill C-21.

Submission of the National Charities and Not-For-Profit Law Section of the Canadian Bar Association, September 2006

Introduction

The CBA Section welcomed the introduction of Bill C-21, the *Canada Not-for-profit Corporations Act,* in the last Parliament.

The current federal legislation governing not-for-profit corporations—Parts II and III of the *Canada Corporations Act* (CCA)—is one of the oldest forms of corporations statute still on the books. It is generally considered by lawyers who work in the sector to be wholly inadequate to regulate the day-to-day affairs of the modern not-for-profit organization. Modern legislation is desperately needed to facilitate the work of the sector. The CBA Section therefore applauded the initiative to reform this area of the law and encourages the government to make the passage of new not-for-profit corporation legislation a legislative priority.

A good not-for-profit corporations law facilitates the work of the sector by reducing the time, effort, and financial cost to the statute's users of obtaining and maintaining incorporated status and providing sound default governance rules that are based on an understanding of the diverse types of organization found in the sector (which range from member-owned golf clubs to industry trade associations to congregational churches).

Although the proposed legislation has been the subject of much study and consultation over the past years, unfortunately, in the CBA Section's submission, it does not deliver the hoped-for modernization of federal not-for-profit corporations law. While it is true that Bill C-21 did contain many very significant improvements in the law, in the final analysis, its failure to incorporate innovations that have been adopted in other jurisdictions in recent years with considerable success render it seriously flawed.

If the Bill is reintroduced in its current form, many professional advisors will be recommending that new incorporations be done under provincial legislation and that existing CCA clients consider continuing under provincial legislation, in order to avoid some of the uncertainties and potential problems described below. This will be of particular importance to religious or quasi-religious organizations, but will also affect any not-for-profits in which the membership does not have a personal economic interest in the activities of the organization. The CBA Section is providing its comments on Bill C-21 in the hopes that the government will make improvements to the Bill before it is reintroduced in Parliament.

Critique of Legislative Philosophy

Jurisprudence and modern scholarship on the corporation regard it as a largely consensual institution and regard corporations legislation as largely default rules establishing basic governance rules.

Bill C-21 appeared to be based on a number of foundational themes, which, for the most part, accord with this scholarship and modern jurisprudence. These include incorporation as of right, abolition of *ultra vires* and the codification of directors' duties. However, there are a number of recurring legislative themes expressed in Bill C-21 which we believe are debatable and which we believe have lead to the introduction of statutory provisions of dubious merit. In particular:

- Governance of not-for-profit corporations is or should be essentially democratic in nature and one role of not-for-profit corporations legislation is to provide imperative rules that enhance the democratic rights of members.

  This proposition is valid only for not-for-profit corporations with members who desire or need strong democratic rights. Typically this will be the case where membership represents a significant economic interest, or where a membership voice is essential to the mission of the organization, such as some advocacy organizations. Democratic rights for members in other types of organizations, however, are not appropriate at all. Large segments of the not-for-profit sector come to the legislative regime with pre-established governance norms which are not democratic or not fully democratic. There is no reason, in our submission, for a corporations statute to impose a single model of corporate governance on all types of organizations, regardless of their mission and pre-established governance norms, or to render the exercise of opting out of these norms unnecessarily complicated and uncertain. If large segments of the not-for-profit sector prefer less democratic regimes, the corporations statute should anticipate this desire by explicitly recognizing alternative governance structures. Without undue complexity, other jurisdictions have been able to draft legislation that responds to the diverse governance needs of this diverse sector.

- Government should exercise a significant regulatory mandate in the governance of not-for-profit corporations and this regulatory mandate should be expressed in the corporations statute.

  Such a proposition is susceptible to abuse unless government policy makers are absolutely clear as to the regulatory mandate for government intervention in the first place. This needs to be clear so that government actors are not drawn into interventions in the sector that serve no real purpose. In our view, for the regulatory mandate to be clear, the legislation which permits such interventions must be part of a law that is applicable to all not-for-profit organizations, not just not-for-profit corporations.

- As much as possible, the new statute should mimic the Canada Business Corporations Act (CBCA) in form and content.

  This proposition, if followed too closely, leads to the adoption of governance norms and remedial regimes which are entirely inappropriate for many not-for-profit organizations. Bill C-21 often fails to recognize the impact of functional differences between for-profit and not-for-profit corporations upon governance and make appropriate accommodation based on those differences.

- A large number of rules should be expressed as imperative ("must") and not as permissive ("may").

> This last proposition overlooks the fact that the purpose of the corporations statute is to facilitate, not regulate, and leads to too many inappropriate imperative rules. It may not be difficult to avoid inappropriate imperative rules in practice. For example, the by-law of a particular not-for-profit corporation might establish a category of "interested party" or "non-member" who would not technically be "members" under the statute, and therefore would not have the imperative or default rights of members. Such a by-law could establish this class of "non-member" and define the entitlements of that class without any regard to the provisions of the statute governing members. To the extent that this sort of 'work-around' develops, it would be an indication that the statute's imperative rules were inappropriate or that the statute did not offer an appropriate variety of default rules. Uncertainty would result if not-for-profit corporations could not predict whether a court would respect such 'work around' governance choices. Bill C-21 does not display an adequate understanding of the diversity of governance norms currently used in the sector. The CBA Section believes it inappropriately imposes norms suitable for mutual benefit-type organizations on all types of organizations.

Section-By-Section Commentary

Part 1 - Interpretation and Application

A number of terms used in the Bill are not defined, including the concept of "religious corporation" and the concept of "surrender." The latter term is analogous to "purchase for cancellation" in the context of for-profit corporations.

Recommendation:

The CBA Section recommends that "surrender" and "religious corporation" should be defined. Alternatively, incorporators should be given the power to self-identify as "religious" in order to attract the application of the rules in the statute governing religious corporations.

The Bill distinguishes between "soliciting corporations" and corporations which are not. "Soliciting corporation" is defined as:

> …a corporation that has in the current year, or in any preceding period that has been prescribed,
>
> (a) requested donations or gifts of money or other property from the public;
>
> (b) received a grant or similar financial assistance from the federal government or a provincial or municipal government or an agency of such government; or

> (c) accepted money or other property from a corporation or other entity that has made a request referred to in paragraph (a) or has received assistance referred to in (b).

The concept is used in the Bill to identify the segment of not-for-profit corporations that are subject to an obligation to account to the regulator.

It appears that in defining the concept "soliciting corporation," the drafters decided that there should be a not-for-profit sector equivalent to the public or offering corporation. Bill C-21 is ambivalent, however, over whether the appropriate analogy to the public shareholder in the not-for-profit context is the not-for-profit corporation's member or its donor. As a consequence, Bill C-21 both enhances democratic accountability to members and it burdens a large segment of not-for-profit corporations (all those "requesting" public funds) with public financial accountability. Entities not organized as federal non-share capital corporations will, fortuitously, escape these requirements.

This regulation of "soliciting corporations" is problematic in three ways. We question whether:

- the federal government has jurisdiction over the regulation of fundraising, which, in essence, appears to be the regulatory objective of the concept "soliciting corporation" and its associated rules;
- it makes sense to include a fundraising regulatory scheme in a corporations statute in any event; and
- the fundraising regulatory regime in Bill C-21 is a good one.

Even if it is accepted that the federal government should regulate not-for-profit corporations in this way and in this statute, the concept "soliciting corporation," in our submission, does not identify the right set of corporations to be regulated.

As a general comment, we note that many portions of the Bill, including the definition of "soliciting corporation," do not include reference to the territories together with references to the provinces. Bill C-21 should be amended so that reference to the territories and territorial governments are added to references to the provinces and provincial governments.

Recommendation:

The CBA Section recommends that the regulatory regime based on the concept "soliciting corporation" be removed from the corporations statute, or, at least, the scope of the regime be reduced by narrowing the definition of "soliciting corporation." If the latter approach is adopted, the concepts "requested," "received" and "accepted" should be removed and replaced with more precise descriptions of the types of fundraising not-for-profit corporations whose operations ought to be regulated.

Part 2 - Incorporation

Paragraph 7(1)(f) requires a statement of the mission of the corporation in the articles of incorporation. "Mission" is not defined. The legal status of the mission statement in the articles of incorporation, or elsewhere, is not clear. Requiring a mission statement in the articles may encourage courts to make associations with objects clauses under the current letters patent legislation and with the associated *ultra vires* doctrine. This would be undesirable. Modern corporate law has abolished the *ultra vires* doctrine because it is fundamentally unsound and because its effects are generally harmful. If there is to be a requirement that the articles of incorporation contain a mission statement, the statute should make the legal function of the mission statement clear.

We recommend, however, that a mission statement not be required in the articles of incorporation. Business corporations are not obliged to state the nature of the business they propose to undertake. There is no need for such a requirement for not-for-profit corporations. Incorporators should be free to incorporate a mission statement in their articles if they so choose.

Recommendation:

The CBA Section recommends that the requirement for a mission statement be removed, or, in the alternative, that the statute state the legal function of the mission statement.

Part 3 - Capacity and Powers

Section 15 deals with pre-incorporation and pre-amalgamation contracts and is taken word-for-word from section 14 of the CBCA. Canadian jurisprudence and commentary have identified serious problems with section 14 of the CBCA. Section 14 fails to distinguish between three different scenarios:

- where both parties to the contract mistakenly believe that the corporation exists;
- where both parties to the contract know that the corporation does not exist but anticipate that it will be incorporated; and
- where the principals of the purported corporation know that it, in fact, does not exist or should know that it does not exist.

The civil liability arising in these fact patterns should be different. In its attempt to deal with the variety of circumstances in which these types of contracts arise, subsection 14(3) of the CBCA gives wide discretion to courts to impose contracts on parties. This is a weak solution to a difficult problem generated by a poorly drafted section.

Recommendation:

The CBA Section recommends that section 15 be redrafted based upon the jurisprudence refining the treatment of pre-incorporation contracts under section 14 of the CBCA.

Part 4 - Registered Office and Records

Section 23 provides for the right of a member of a not-for-profit corporation to have access to the corporate records. Members and holders of debt obligations are also entitled to obtain a list of members. The person requesting access must provide a statutory declaration. That person must use the list of members for relevant corporate purposes.

Reasonable people will disagree over the advisability of this type of provision. One of the themes of the proposed legislation is democratic accountability to the membership of the corporation. This rule is intended to enhance the rights of members. We recommend that the rule be permissive, since not all not-for-profit corporations are or should be democratic in the way contemplated by the draft legislation.

Recommendation:

The CBA Section recommends that section 23 be redrafted to make it permissive, not imperative.

Part 5 - Corporate Finance

All not-for-profit corporations statutes contain a non-distribution constraint that prohibits or restricts distribution of corporate property to members and fiduciaries during the existence of the corporation and on dissolution.

The draft legislation states the first segment of the non-distribution constraint in section 35 as follows:

> … no part of a corporation's profits or of its property or accretions to the value of the property may be distributed, directly or indirectly, to a member, a director or an officer of the corporation except in furtherance of its activities or as otherwise permitted by this Act.

Subsection 35(2) provides an exception to this prohibition:

> If a member of a corporation is an entity that is authorized to carry on activities on behalf of the corporation, the corporation may distribute any of its money or other property to the member to carry on those activities.

The formulation of the non-distribution constraint is weak. It is unclear whether the prohibition applies during the existence of the corporation as well as on dissolution. Section 234, in fact, contemplates the possibility of distributions on dissolution to members in the case of non-soliciting corporations. Further, the exception is poorly conceived. For example, it should be possible for a foundation to make grants to its associated operating charity. Such a grant is likely to be prohibited by section 35(2). Whether such a grant is permitted depends on whether the foundation is "authorized to carry on activities" on behalf of the operating charity. This constraint does not make any sense in the case of the typical foundation/operating charity relationship.

Recommendation:

The CBA Section recommends that the non-distribution constraint should be stated more clearly and precisely.

Part 6 - Debt Obligations, Certificates Registers and Transfers

We have reviewed Part 6 (sections 38 to 104) carefully. We are not clear as to why such a detailed regulation of debt obligations is needed in a not-for-profit corporations statute.

Recommendation:

The CBA Section recommends that Part 6 be removed from the statute.

Part 7 - Trust Indentures

No comment.

Part 8 - Receivers and Managers

No comment.

Part 9 - Directors and Officers

Section 126 states that a soliciting corporation shall have not fewer than three directors, at least two of whom are not officers or employees of the corporation or its affiliates. The Bill permits all other corporations to have just one director. Assuming the statute is correct to regulate soliciting corporations, which we question, it perhaps makes sense that a soliciting corporation should have a more substantial board of directors with a degree of independence from management. In our submission, however, the current definition of soliciting corporation is too broad and too many corporations will be subject to this requirement. As noted above, we recommend that the concept of "soliciting corporation" be removed from the Bill, or at least narrowed.

Section 134 permits the members of a corporation to amend the articles to change the number of directors. Where the members do this, they may elect the number of directors authorized by the amendment. However, where the directors fix the number of directors between an already existing minimum and a maximum, there is no corresponding power to elect directors to fill the additional places. Under subsection 129(8), the directors may appoint additional directors if the articles so provide. It is not clear, however, whether subsection 129(8) would permit the directors to appoint additional directors where the vacancies have been created by a directors' resolution increasing the number of directors.

Recommendation:

The CBA Section recommends that the Bill should permit members to elect directors when the number of directors is increased by directors' resolution.

Part 10 - By-laws and Members

Section 163 gives voting members a right to submit proposals to the corporation for discussion at a members' meeting, analogous to the shareholder proposal

provisions of the CBCA. It is intended to enhance democratic governance. The CBA Section does not object to this requirement.

Section 170 provides for "unanimous member agreements," analogous to the unanimous shareholder agreement under the CBCA. Although the CBA Section does not see any particular problem with providing for such agreements, it is somewhat peculiar when applied in the not-for-profit context. In our collective experience, where a not- for-profit corporation has wanted to simplify its governance structure, the flow of power has been away from the members to the directors. The need, typically, is to do away with members, not directors. An example of this is the self-perpetuating board, a very common governance structure in the sector.

A regime to facilitate self-perpetuating boards would do away with or simplify many of the member democracy rules. The statute does not contemplate this possibility.

Recommendation:

The CBA Section recommends that there should be a provision that facilitates self-perpetuating boards.

Part 11 - Financial Disclosure

Section 175(1) provides that the financial information prepared by the corporation be distributed to all members except those who inform the corporation in writing that they do not want a copy. Section 175(2) permits corporations to opt out of the distribution requirement if the by-laws so provide. In that case, the corporation must still make the information available to members on request. We do not have a view as to whether the rule in Section 175(1) is the appropriate default rule. Again, section 175 appears aimed at enhancing democratic accountability. We question whether the default and imperative rules in the Bill have indeed resulted in a workable governance regime for not-for-profit corporations of all types. Section 176 requires soliciting corporations to send the financial information to the Director under the statute. In the CBA Section's view, this requirement is misguided. Even if it is wise for Industry Canada to have a regulatory role for not-for-profit corporations, the concept "soliciting corporation" casts far too wide a net. Our recommendations with respect to the use of this concept are outlined above.

Recommendation:

The CBA Section recommends that Industry Canada study whether Section 175 is an appropriate default rule.

Part 12 - Public Accountant

The audit regime divides not-for-profit corporations into two categories: designated corporations and corporations that are not designated. Designated corporations include soliciting corporations and non-soliciting corporations with annual revenues up to a prescribed amount. Members of a designated corpora-

tion may resolve not to appoint a public accountant. All the members entitled to vote at an annual meeting of members must pass the resolution. The resolution is valid until the next meeting of members. Otherwise, members of both designated and non-designated not-for-profit corporations must appoint a public accountant. Under section 187, the public accountant of a designated corporation is required to conduct a review engagement in the prescribed manner. The members may pass an ordinary resolution requiring the public accountant to conduct an audit engagement. Public accountants of corporations that are not designated corporations are required to conduct an audit engagement in the prescribed manner. The exception is a corporation that is not a designated corporation that has annual revenues of equal to or less than a prescribed amount or where the members pass a special resolution requiring only a review engagement.

In our view, the requirement to engage a public accountant places an undue burden on many not-for-profit corporations.

Recommendation:

The CBA Section recommends that the statute should not impose an imperative audit regime on any not-for-profit corporation.

Part 13 - Fundamental Changes

Fundamental changes require the approval of the members by special resolution, and members that otherwise do not have a right to vote, would have a right to vote.

In our view, an imperative rule enfranchising non-voting members where the rights of their membership may be modified is appropriate. This is provided for in section 197. However, we do not think it is appropriate as an imperative rule for fundamental changes such as amalgamations, continuances to other jurisdictions, and extraordinary sales, leases or exchanges of the corporation's property. There are many instances where such a requirement would be unduly burdensome for some types of not-for-profit corporations and where proceeding with the fundamental change without membership approval would not cause any harm to the members. The rules on this issue should therefore be default rules.

As suggested above, a not-for-profit corporation could create a class of "interested person" or "non-member" who would not be a "member" and therefore not be inappropriately enfranchised for the purposes of the fundamental change rule. In our view, forcing organizations to put in place such work-arounds is not appropriate if the numbers of organizations affected is significant.

Recommendation:

The CBA Section recommends that the fundamental change regime should operate as default rules.

Part 14 - Liquidation and Dissolution

Section 222 gives the court the power to order the liquidation and dissolution of a not-for-profit corporation if certain conditions are met. Section 222(2) allows the court not to make such an order if it is satisfied that the corporation is a "religious corporation." In that case, the court must be additionally satisfied that the corporate behaviour complained of is based on a "tenet of faith" and that it was reasonable to base the behaviour on the particular tenet of faith.

"Religious corporation" is not defined, although it was in a previous version of the Bill. We think that the court's power in section 222 with regard to religious corporations may cause difficulties. For example, to obtain such an order a member can show that an act or omission of the corporation has been unfairly prejudicial to them or that it is just and equitable that the corporation be liquidated and dissolved. Given the complexity of matters of faith in most religions, it is not difficult to imagine situations where a court might act to dissolve a "religious corporation" in an inappropriate way.

Recommendation:

The CBA Section recommends that the liquidation and dissolution regime should make more judicious use of imperative rules and more liberal use of default rules and the Bill should not give courts such an expansive jurisdiction over religious corporations.

Subsection 233(2) contains a formulation of the second half of the non-distribution constraint. For certain corporations, the articles must provide that any property remaining on dissolution shall be distributed to one or more "qualified donees." The corporations caught by this provision are:

- registered charities;
- soliciting corporations; and
- a corporation that has within the prescribed period requested donations from the public or received grants from government, or accepted money from a corporation that has made such requests or received such grants.

All not-for-profit corporations should be required to state clearly in their articles what happens to their property on dissolution. Further regulation on this issue might be provided in other statutes. For example, the *Income Tax Act* will presumably continue to provide that the property of a registered charity on dissolution can only be distributed to a qualified donee. That is a regulatory issue that uses an appropriate regulatory concept - "registered charity" - in the context of a well-developed regulatory regime in the *Income Tax Act*.

However, even if it is appropriate for a corporations statute to play a regulatory role in this regard, we do not think that section 233 sets out the appropriate rule. In particular, we do not see the basis for requiring soliciting corporations that are not registered charities to provide in their articles that the property on dissolution

is to be distributed to one or more qualified donees. This is not the only reasonable distribution and therefore there is no reason to require it.

Recommendation:

The CBA Section recommends that the mandatory distribution to qualified donees should be removed from subsection 233(2).

Section 234 permits the articles of a corporation to provide for distributions to members. In our view, this is an appropriate rule. However, there is no attempt in the formulation of the rule to make it consistent with the first half of the non-distribution constraint in section 35.

Recommendation:

The CBA Section recommends that the non-distribution constraint be redrafted so that it is clear and consistent.

Part 15 - Investigation

No comment.

Part 16 - Remedies, Offences and Punishment

Part 15 extends the shareholder remedies of derivative action and action relief from oppression to not-for-profit corporations. Exceptions exist for "religious corporations," which permit a court to refrain from making the relevant order where the relevant corporate decision is based on a "tenet of faith" and in the court's opinion it was reasonable to base the decision on a tenet of faith. These rules exhibit a strong policy choice in favour of a remedial regime substantially the same as for-profit corporations with minor discretionary exceptions. The policy choice is based on the apparent premise that members of a not-for-profit corporation are substantially analogous to shareholders of a business corporation. To the extent that this assumption is not true, the rules of Part 15 will be entirely inappropriate. One important question is whether the discretionary faith-based exemption is a sufficient accommodation of the distinctiveness of religious not-for-profit corporations.

The CBA Section's view is that it is not. There should be stronger exemptions for religious corporations from both the derivative action and the action for relief from oppression. With respect to for-profit corporations, the derivative action is less problematic since whether it succeeds or not turns on whether the fiduciaries of the corporation have breached their fiduciary obligations. It makes sense to put the power to ask that question in the hands of members, and not the fiduciaries themselves. This concession merely reverses the rule in *Foss* v. *Harbottle*,[*] which holds that only the fiduciaries of a corporation—the board of directors—can cause the corporation to sue a fiduciary.

The action for relief from oppression, however, is more problematic. Making this remedy available to all members of all not-for-profit corporations is not, in

* (1843) 2 Hare 461, 67 ER 189.

our submission, appropriate. Where a member does have an economic or quasi-economic interest (for example, as a member of a golf club), the incorporators and the membership will usually establish or should establish a detailed contract stating the economic and other rights of the member. These regimes could well be more subtle and detailed than the share terms of a for-profit corporation. The contract will also establish the basis of the members' remedies. It may still make sense for that type of case to provide for a general power of the court to intervene, as the oppression remedy does. Where a member of a not-for-profit corporation does not have such an economic or quasi-economic interest (for example, as a member or director of a foundation or as a director of a self-perpetuating board), the complaint of misbehaviour would typically not be easily described as behaviour that is "oppressive or unfairly prejudicial to or unfairly disregards the interests of" a member. On that basis, the CBA Section's view is that this part of the statute requires a great deal more thought.

Recommendation:

The CBA Section recommends that the remedies provided for under Part 16 should be redrafted in their entirety.

Conclusion

As noted above, Bill C-21 represented an attempt to address the much-needed reforms to the governance of not-for-profit corporations. The CBA Section hopes that the government will re-introduce legislation to effect these reforms, but in a manner that remedies the defects in the Bill highlighted above. Any proposed Bill must recognize the diversity of not-for-profit corporations and that their governance needs may be different from those of for-profit corporations. We hope that our comments provide helpful insight on the kind of legislation that is required to meet the needs of this unique sector.

Brief of Miller Thomson LLP respecting Bill C-21 *Canada Not-For-Profit Corporations Act*

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Introduction

Experience of Miller Thomson LLP

Miller Thomson LLP is a full service law firm with offices in Vancouver, British Columbia; Whitehorse, Yukon; Calgary and Edmonton, Alberta; Guelph, Kitchener, Markham and Toronto, Ontario; and Montreal, Québec. A significant amount of the legal work done in all of our offices relates to or is connected with Canadian not-for-profit activity. Our lawyers have incorporated literally hundreds of Non Share Capital Corporations, Societies and Charities ("NFP's"),

and, on an on-going basis, continue to advise such organizations on all manner of legal issues.

We have several lawyers whose professional practice is restricted to legal matters involving such organizations, some of whom have been incorporating and advising NFP's for over four decades. And we have broad experience on both sides of the table, having served as directors, and in virtually every office of, charitable and non charitable corporations.

Perspective of MT

Considering especially how long it has taken to get to the point of the presentation of a new statute, the modernization of the legislation for NFP's is a major step forward. A number of the new features introduced in Bill C-21 represent a significant advance towards parity with the legislation in the commercial world. Since many, if not most, of these features have already been noted by others, it is unnecessary to waste the time of the Committee by repeating them. Suffice it to say that the NFP community will find the modernization as welcome change. In the interest of expediency, this Brief will focus on what we believe to be significant gaps or shortcomings in the Bill.

Impact of Deficiencies

These gaps or shortcomings will lead to an avoidance of the use of this Statute for incorporation. In fact, Miller Thomson LLP is already advising clients in some operational areas that it is expressly contrary to their continued good corporate health to consider incorporating federally. Miller Thomson LLP offers this advice with considerable reluctance, but we must recommend what we consider to be in the best interest of our clients.

In large measure, our assessment of the shortcomings arises from extensive experience, and a full appreciation and understanding of the fundamental and practical differences between the nature and operations of Business Corporations and NFP's.

1. Unique Nature of Not-For-Profit Corporations

Fundamental Flaw in Approach to Legislation

It is clear from the text, and from what has been published to date by the Ministry, that the drafters of the Bill have done so from the perspective of what prevails in the world of commercial corporations. Both in published background material and in discussions led by the Corporations Directorate, there seems to be great pride in the fact that Bill C-21 follows and adopts the concepts and principles of Business Corporations. It is equally clear that the drafters of the Bill lack substantial experience in the world of Not-For-Profit Corporations. For this reason, the text demonstrates a fundamental flaw: most Not-For-Profit Corporations—and certainly all charitable corporations—are substantially different from commercial corporations.

Not the Same as Business Corporations

Despite similarities to the world of commercial for-profit corporations, Not-For-Profit Corporations are not the same as Business Corporations. Because they have quite different requirements for their operations, it would be a gross mistake to believe that the principles applicable to commercial corporations can and/or should be applied without major variation for Not-For-Profit Corporations.

Even granting the relatively smaller number of Not-For-Profit Corporations that do have a purpose intended to provide a benefit to their own members, such as golf and social clubs, significantly greater numbers of Not-For-Profit Corporations (in particular, charitable corporations and authorities operating public facilities) are incorporated and organized for a broadly described public benefit. To treat all such corporations identically and as essentially the same as Business Corporations is to misinterpret the respective substantial natures of each. To use an analogy, regardless of the similarity of the noun, cookies that are placed upon one's computer by certain internet web sites are not the same as cookies that are baked in an oven.

2. Specific Concerns

"Statement of Mission"

It is unclear:

> what a "statement of mission" is,
>
> why the concept of "objects" has been abandoned in favour of a "statement of mission."

This is not a mere academic musing. The traditional "objects" concept has known meaning on which charitable organizations depend for approval as charity, both as a matter of legal concept and for the purposes of the *Income Tax Act* and its administration by the Canada Revenue Agency ("CRA"). Without a correlative amendment to the *Income Tax Act*, there is no assurance that existing charities when continued as required under this new statute will continue to qualify as charities for the purpose of the *Income Tax Act*.

> **IT IS RESPECTFULLY SUBMITTED** that appropriate coordination with the requirements of Canada Revenue Agency respecting charitable corporations be included in Bill C-21.

Definition of "Consensus"

Related to the proper use of language in the grammatical sense, is the provision permitting, even encouraging, the distortion of the meaning of "consensus"? There is little divergence of meaning reflected in any of the English language dictionaries, yet §138 permits a by-law to define the term as it pleases.

> **IT IS RESPECTFULLY SUBMITTED** that the section should be altered to provide that consensus at its minimum must contemplate the absence of final objection to a matter.

Financing

The breadth and depth of Parts 5, 6 and 7 of Bill C-21, although perhaps suitable for Business Corporations, go far beyond the needs of the Not-For-Profit sector. For this sector, a simple borrowing power, much as already exists, along with existing provincial securities legislation, is more than adequate to meet the needs of the sector, both for the corporations themselves as borrowers, and their lenders.

> **IT IS RESPECTFULLY SUBMITTED** that Parts 5, 6 and 7 be recast to mirror the present section 65 of the *Canada Corporations Act*.

Unreasonable Breadth of "Soliciting Corporation"

"Soliciting Corporation" includes 2(1)(c) -- a corporation that has received money/property from a corporation that solicited donations or grants, or received governmental grants. We act for clients that are trade associations incorporated under this Act that will be "soliciting corporation[s]" when the associations respectively provide educational programs to organizations that are funded *in any part* by donations or government grants.

> **IT IS RESPECTFULLY SUBMITTED** that the definition of "Soliciting Corporation" be narrowed so as to exclude corporations that, acting at arm's length, sell products or services to Soliciting Corporations.

Questionable Constitutionality of Certain Sections

A number of sections may very well be unconstitutional, attempting to usurp provincial rights over property and civil rights, in that they may be construed as regulating fundraising. These include §33, §34, §132(4), §144. The problem could most likely be cured by introducing the sections with the phrase "Subject to the requirements of law."

Of particular note is the potential impact of §33 which represents, for charities, a radical, and it is submitted a perilous, departure from the law of trusts.

Unreasonable Voting Rights Given to Non-Voting Members

Non-voting members are given voting rights even where their interest is not affected [see §197, 204(3), 211(4), 212(4), 218(2), 218(3), 219]. Moreover, a non-voting class has authority to prevent change even when approval of all other (voting) classes has been obtained. It is entirely unfair to grant voting rights to a class that has no voting rights (*i.e.*, honourary members). It is even more unfair to afford a non-voting class a right to veto a provision that all voting classes elect to adopt. This is especially tyrannical in cases in which non-voting members are numerically insignificant.

A number of rights given to members parallel rights that may be appropriate in the context of a share capital corporation where a shareholder has an ownership right; but in the case of virtually all non-profit corporations, members do not have an ownership right rather have a mere non-pecuniary interest. Such sections [§132(2), 163, 186] open the door to enormous mischief at the irreparable expense of the corporation.

As previously noted, such provisions as those noted in this section will drive applicants away from incorporating federally.

> **IT IS RESPECTFULLY SUBMITTED** that voting rights be removed from non voting classes of membership.

Oppression

Both members and other interested persons (defined as "complainants") are given rights to attack decisions of a corporation on a derivative and an oppression basis. It is not appropriate to grant to members and non-members rights to attack corporate decisions beyond the rights that accrue by virtue of membership. While the derivative action and oppression claim concepts may be appropriate in the business corporation context where shareholders have property or ownership interests to protect, such actions and claims are not appropriate in the NFP sector.

We are particularly concerned about the inappropriateness of these provisions in the context of a religious corporation. While a decision of a religious corporation based upon a tenet of faith is ostensibly excluded, we are not confident that courts will interpret the exclusion for decisions "based on a tenet of faith" as broadly as religious corporations consider necessary to protect faith-based decisions, or as broadly as they would wish. The reality is that religious corporations almost uniformly consider all of their decision-making to be informed by and based upon faith. Religious corporations also often have governance structures based upon principles that are explicitly not democratic in that members may have, as a result of religious considerations about church governance, very limited voting rights in both spiritual and temporal affairs. In fact, some denominational corporations are designed so that the governing body is, as a matter of religious understanding and current corporate law, an entirely self-perpetuating body.

The addition of an oppression remedy has the potential to wreak havoc on religious corporations with these types of governance structures by giving corporate law rights to individuals who may be considered to be adherents or even "members" in a religious sense, but who are not corporate members.

Similar concerns arise in the context of non-religious NFPs that are involved in contentious issues. What advocacy organisation would want to expose itself to an oppression action by a member or non-member unhappy with an advocacy position?

We have already begun to advise religious charities that, if Bill C-21 becomes law, consideration should be given to insulating their religiously motivated governance from the above concerns by "moving" their governance to provincial jurisdiction or seeking a federal special act.

> **IT IS RESPECTFULLY SUBMITTED** that the derivative action and oppression claim concepts be removed from the legislation.

Grammatical Errors

There are many grammatical errors adopted — the use of plural pronouns refer to singular nouns — in an attempt to render the text gender neutral[†]. Other language[‡] can be and has been adopted to achieve gender neutrality without resort to incorrect grammar.

> **IT IS RESPECTFULLY SUBMITTED** that proper grammar be adopted throughout the Bill.

3. Omissions

Unique Qualification of Directors

Section 127 appears to exhaust the establishment of qualifications of directors, yet in a large number of NFPs including many charities and most religious-based organizations, there are special or particular qualifications for directors going well beyond the statutory.

> **IT IS RESPECTFULLY SUBMITTED** that a provision should be added to permit the corporation to establish, by by-law, special or particular qualifications of its directors.

Conflict of Interest Restrictions Insufficient

The conflict of interest provision, §142, is woefully deficient and affords less protection than what is already provided by the common law. The section should be dropped in favour of the common law protections, or should be altered to provide adequate "teeth" prohibiting a director to influence the outcome where the director has a direct or indirect interest.

> **IT IS RESPECTFULLY SUBMITTED** that extensive revisions be added to incorporate the concepts adopted in sections 2, 3, 5 and 6 of Ontario *Municipal Conflict of Interest Act* Revised Statutes of Ontario 1990, c.M.50, as amended.

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† see sections 21(7), 106(1), 111(a), 111(c), 114, 115, 124(a), 124(b), 124(c), 124(e), 124(f), 124(g), 140, 142(4), 145, 146(6), 149(1), 149(4), 152(3), 158, 186(2),

‡ Alternative language has been used, as for example, in section 150(1).

Absence of Ex Officio Directors

There is no provision for either member or directors *ex officio*. Under the existing statute, persons come onto the board directors of NFPs by election, by appointment, or as *ex officio*, that is by virtue of the holding of some other office. As typical of NFPs generally and charities in particular, while in office, the mayor of the community where the hospital is situate, or the chair of the board of a one charitable organization, serves as director of a related charity. Bill C-21 should not be permitted to jeopardize such continued interlocking relationships.

It has been suggested that the power given in §129(8) to permit a Board to appoint up to one-third of the Directors is an appropriate alternative to providing for *ex officio* Directors. This is *not* a reasonable alternative, for even if it had such power as is given in §128(8), there is no assurance whatsoever that a person appointed pursuant to such power would be the incumbent in that other office.

> **IT IS RESPECTFULLY SUBMITTED** that provision should be made for Directors *ex officio*.

No Obligation to Record Director's Dissent

While §148 permits a director to dissent, there is no correlative obligation for the minutes to record such dissent.

> **IT IS RESPECTFULLY SUBMITTED** that there be added a legal obligation that the dissent of a director be recorded in minutes.

4. Unreasonably Burdensome Provisions

Appointment of Directors by Directors

Historically, in the case of both Business Corporations and NFPs, a Director obtains the position of Director by election by, respectively, the shareholders and the members (in this sense, they are the "servants" of the shareholders/members). The exceptions to this virtually universal rule are very narrow: in the case of *ex officio* Directors and in the filing of a casual mid-term vacancies.

Introduced in subsection 129(8) is an entirely new concept—and incidentally one that is inconsistent with the otherwise general rule that members select Directors—pursuant to which Directors have the authority (assuming the Articles so provide) to appoint further Directors, the number not exceeding one-third of the number of elected Directors. This translates into a right to appoint as many as one-half of the number of elected Directors.

This is a fundamental and radical change that can be expected to encourage substantial mischief, especially where there is divided opinion among members and Directors. Consider the following example:

> In an attempt to take control of the Board of Directors in a contested election, one faction of the membership puts forward one candidate for each vacant position. The membership elects half of the Directors from this slate, and the other half from another slate. Illness prevents one of the second group of Directors from attending the first meeting of Directors. The first group of Directors then appoints the candidates from their group who were not elected, that is, a number of Directors equal to their initial number of elected Directors.
>
> Thus, although the members elected a balance of Directors, with half being representative of each group, the balance has been entirely destroyed as a result of the power to appoint further Directors.

The arguments made in favour of this kind of authority can be captured in the concept that it permits an organization to ensure a balance of Director representation, by granting a voice (a Director) who represents a constituency that would otherwise not have a right to be heard at the Board of Directors table. It is respectfully submitted that other, better, and clearly more democratic, solutions exist to solve such a problem, the principal one of which is a refining of the electoral process to ensure representation for each constituency that the members consider should be represented at the Board table. It is respectfully submitted that it is ultimately for the ***members, not the Directors***, to determine how constituencies are to be represented.

The possible benefit of including such a provision as this is greatly outweighed by the potential for mischief.

> **IT IS RESPECTFULLY SUBMITTED** that §129(8) should be removed from the Bill.

Director as Insurer of Legality

Under §148(3), every director is required to verify the lawfulness of the articles and mission of the corporation, which is impractical in the extreme, and no sensible purpose is discernable in its inclusion (except, perhaps, to afford some insulation from public criticism to the office of the Director in the case of an incorporation the articles and mission of which is subsequently found to be unlawful). Apart from the obvious issue as to the technical and legal ability of a director to verify lawfulness, the cost of compliance will discourage volunteer directors.

> **IT IS RESPECTFULLY SUBMITTED** that this provision be eliminated.

Requirement for Court Order

Under §160(2), a court order is required in order to permit an extension of time for the holding of the annual meeting.

Provisions establishing the timing of annual meetings have long been considered to be directory, with variations left in the hands of either the directors or the members. This section introduces far greater formality than is reasonably

required for adequate protection of the interest of members. To require, moreover, that a corporation obtain a court order extending the time is unreasonably expensive for many smaller and/or charitable corporations.

> **IT IS RESPECTFULLY SUBMITTED** that if the general right of members to requisition a meeting is considered to be insufficient (of which there is no evidence to suggest that this is so), the authority to grant this type of relief should be vested in the Director, where the proceeding will (or should) be less formal and costly.

5. Conclusion

Support for Initiative that Bill C-21 Represents

Miller Thomson LLP supports that modernization of the law governing NFPs. Many of the features of Bill C-21 represent a significant advance in the legislation for this important segment of Canadian society.

Fundamental Issues Must Be Addressed

It is respectfully submitted, however, that the issues addressed in this Brief are fundamental, and need to be tackled ***before*** the legislation is passed. If they are not, many NFPs would be better off under the existing *Canada Corporations Act*, or under corresponding provincial statues.

Willingness of Miller Thomson LLP

Miller Thomson LLP is willing to devote time and resources to share its collective experience in an effort to assist in producing a statute that could become a model for the NFP world.

All of which is respectfully submitted this 13th day of March 2006.

MILLER THOMSON LLP
Per:
Hugh M. Kelly

Brief to the Industry Committee House of Commons re: Bill C-21, *An Act Respecting Not-For-Profit Corporations and Other Corporations Without Share Capital*

DON BOURGEOIS
Barrister and Soliciter, Kitchener, Ontario
March 21, 2005

Introduction

Thank you for the invitation to provide comments on Bill C-21, *An Act respecting not-for-profit corporations and other corporations without share capital*.

This Bill is an important piece of legislation—perhaps more important than it appears to be at first blush. My major comment is, therefore, "to get on with it."

The need for new, modern and flexible legislation for the incorporation and governance of not-for-profit corporations at the federal level was recognized when I was in high school—perhaps even earlier. When I was in university, the federal government proposed a new "Canada Non-Profit Corporations Act" (1977). I am now a few years from retirement and am hopeful that there will be more appropriate legislation in place before I do retire.

My primary recommendation is, therefore, "to get on with it." We are all aware of the political situation in the House and the potential to use such Bills as part of the partisan political process. While that approach may be understood from within Parliament, it is very difficult to understand from the outside looking in. There are about 18,000 corporations and likely more than 100,000 officers and directors who are using—or attempting to use—legislation that is based in the 19th century to meet Canada's needs in the 21st century.

Comments

The Bill is not perfect; having drafted statutes, regulations and other statutory instruments, I have concluded that perfection is not possible and assessments of perfection are more often than not based on the perspective from which one comes to a matter. The Department's lawyers and policy advisors have done, overall, a very good job in implementing the suggestions that were made through a lengthy consultation process. Nevertheless, I am here to comment and provide my views on perceived weaknesses in the Bill and will do so.

- Subsection 6(1) – a minimum of 3 incorporators is more appropriate for these types of corporation than a single incorporator. The vast majority of corporations without share capital will be either charitable in nature or membership-based organizations. One incorporator is not appropriate for such organizations for legal and public policy reasons. If an organization cannot locate 3 individuals to be incorporators, it ought not to be incorporated under the new legislation.
- Subsection 7(1) – there should be specific objects for corporations without share capital. A "mission statement" may be appropriate for such purpose but it is usually too vague or ambiguous for legal purposes. It is not clear how para. 7(1)(e) would operate. Given that the corporations will have the powers of a natural person, the concept of a "mission statement" would seem to be too flexible. No doubt the policy rationale is to deal with the *ultra vires* issue with "objects" but in my view has gone too far. It could allow corporations with an ambiguous mission statement to operate businesses, such as a string of gas stations. I have similar comments on section 16.

- Para. 7(1)(c) – the inclusion of this requirement seems inconsistent with the overall thrust of the Bill. It would be better to address this issue in the by-laws, given the approach in the Bill to permit greater flexibility.
- Subsection 28(1) – the onus should be reversed, i.e., if permitted by the by-laws or articles. The concern is that the majority of the corporations will be small and will not have sophisticated governance structures. Furthermore, the members should be able to make this decision, not the "single incorporator" that is being contemplated under section 6.
- Section 32 – the interaction of this section with the law of charities, which is based on trust law in the common law provinces, is not clear. Not all property would be held "expressly in trust" but it is implied under the law of charities. All assets of a charity are held in trust for the charitable objects of the corporation. This point also relates back to the issue of "mission statement" versus "objects."
- Part 6 – the concept of "debt obligations" is problematic, at least as drafted. It is not readily understood and, in my experience, what is not readily understood is open to abuse, inadvertent or deliberate. The broad scope of this Part would permit the holders of debt obligations to control, in effect, the corporation such that it is no longer a "not-for-profit" corporation but a corporation with shares in all but name. This problem is aggravated by the concept of a "mission statement." Given my primary recommendation "to get on with it," I suggest that the issue of debt obligations be addressed in regulations rather than in the statute.
- Section 126 – there should be at least 3 directors for any corporation without share capital, given the nature of the organization and its purpose. In addition, there are potential issues with respect to the *Income Tax Act* where a single person controls the corporation. Similarly, I am concerned with section 139 and the concept of a managing director in this sector.
- Section 143 – this section may prohibit the election of officers directly by the members. A number of corporations without share capital elect the officers directly by the members at the annual general meeting.
- Soliciting and Non-Soliciting Corporations – this issue is one for which there is no right answer. Should a soliciting corporation be "soliciting" forever? If it is a charitable corporation, probably it should be. I do not have a firm view on what the balance should be between the need and effectiveness of an audit and its costs, but raise it as an issue. I expect others have also identified the issue.
- Section 239 – it is not clear whether or not it would be subject to any charitable trust.
- Transition – my inclination would be to have the continuation as a matter of implementation of the statute. If the policy reason for not having auto-

matic continuation is to "weed out" non-operational corporations, a good safety net should be in place event after the 3 years. The dissolution would have a serious impact on charitable property issues.

Conclusion

Thank you for inviting me to be a witness before the Committee. I appreciate the opportunity and trust that my comments have been of assistance to the Committee. I urge the Committee to move expeditiously on the Bill.