

# Viewpoint

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## **The Non-Share Capital Corporation: Looking Beyond Incorporation and Organization\***

JOHN M. HODGSON

*Blake, Cassels & Graydon, Barristers and Solicitors*

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### **Introduction**

No rational person who is respectful of economic reality, life's fleeting span, and the pleasures of recreation, home and friendship will ever become involved with non-share capital corporations. They are founded by zealots, staffed by workaholics, and operated by slave labour euphemistically called "volunteers".

As subscribers to *The Philanthropist*, we are obviously among those for whom this message has arrived too late:

Like Macbeth, I fear —  
We are in blood —  
Stepped in so far that should I wade no more  
Returning were as tedious as go o'er.

This paper will not, therefore, address the relatively straightforward problems of incorporation and organization. Instead I shall be exploring some of the pitfalls that lie in wait for those who believe that successful incorporation and organization are the keys to continued organizational success.

### **Problems of "Continental Drift"**

The founders of an organization are likely to think of it in very particular terms. They know what they want because the base they begin with is something which is already underway:

- They have run a series of noon-hour concerts in a community hall;
- They are providing a drop-in centre for "bag ladies";

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\* This paper has been developed from a presentation to a Canadian Bar Association (Ontario) Seminar on *Non-Share Capital Corporations*.

- They are Brazilian immigrants and wish to preserve cultural and educational ties with Brazil; or
- They have organized a “breakfast club” for children of working parents to bridge the gap between the parents’ home-leaving at 7 a.m. and the children leaving for school at 8:30.

They may, on the other hand, be recusants of an existing organization and so they know emphatically what they do not want:

- They do not want government interference in the education of their children;
- They do not want the continued disruption caused by a lack of co-ordination in some community activities which are currently at loggerheads;
- They do not want an association of lawyers which fails to fight for their interests because it is buckling under the pressure of the Law Society or the Attorney-General.

Whatever their backgrounds, the organizers of a non-share capital corporation usually come to their legal advisors with a clear concept of what they are going to be doing and, left to themselves, they will probably set this out very specifically as their objects.

From this peak of consensus there is all too often a descent into “continental drift”.

The theory of continental drift applied to organizations is very simply stated: there appear to be irresistible forces which cause organizations to assume new and unanticipated roles in their struggle to survive. The theory pinpoints two dangers: the first is the inflexibility of the structure of the organization which *prevents* its accommodation to change. The second is the insensitivity of the organization *to* changing circumstances.

The first danger is the obvious one. The incorporation links two elements at a point in time:

- an organizational structure; and
- a statement of objects.

There is a danger in doing this that you create the immovable object which must then contend with the irresistible force.

The spectre which haunts all non-share capital corporations is the spectre of *ultra vires* acts. Serious questions arise when, for example:

- the noon-hour concerts lead to the organization of a full-time choir;
- the drop-in centre becomes an old people’s home;
- the Brazilians open a Portuguese language school;

- the breakfast club starts serving lunch.

Do the objects of the corporation extend to include this change in emphasis?

Fortunately, most groups in the throes of organization either co-opt or consult a lawyer and the meagre stock of precedents available to most of us in the profession is likely to result in the documents they receive, in contrast to the documents they contemplate, being general enough to form the charter for a New Jerusalem. It is nonetheless necessary to remain aware of the perils of *ultra vires*.

The second danger of organizational or, as I prefer to style it, “continental” drift is more insidious and therefore more difficult to avoid. It is one aspect of organizational control and I call it the “school-of-business syndrome”. It flows from the assumption that theories of management which have proven valid for commercial organizations apply equally to non-profit organizations. It leads, among other things, to the selection of the organization’s activities on the basis of economic return and, in my apprehensive mind, to staff dominance of organizational activity. It also leads to concentration on the questions of how well (or how poorly) the organization is delivering a service (an effectiveness question) given the level of resources available to it (an efficiency question). Both of these questions are important, but this concentration totally fails to take into account the significance (or insignificance) of the service itself and the distribution of services in relation to demand.

If there is any solution to the school-of-business syndrome, I have always thought that it lay in the area of the organization’s constituency, a concept which I will come to shortly. I personally equate the continued success of a non-profit corporation with its ability to achieve a real and continuing grass roots participation in its control so that it is not only aware of, but responds to, the changing environment.

### **Problems of Constituency**

I am using the word “constituency” to mean the body of people to whom an organization is responsible and accountable.

The corporation may be a legal “person” but it lacks a mind, a will and a personality except as these are provided by its officers. In this respect it brings to mind the sad wail of the Scarecrow in the *Wizard of Oz*, “if I only had a brain”. It also brings to mind the Wizard’s imaginative response: he presented the Scarecrow with the diploma of an honorary degree.

Whether in fact the corporation can be demonstrated to acquire a group will distinct from that of the human beings who operate it is a question that lawyers very rightly refuse to address. The legal approach is exemplified in the old case of *Citizens’ Life Assurance v. Brown*, [1904] A.C. 423, 426. In that case Lord Lindley, for the Privy Council, responded to the argument that the appellant corporation could not be found guilty of libelling the respondent because an essential legal element of the charge was that of malice and malice cannot be

imputed to a corporation. Lord Lindley simply refused to become involved in metaphysical subtleties. He concluded that if the employee of the corporation had published the libel in the course of his employment, the corporation was liable for it in the ordinary principles of agency.

He approved the judgment of the lower court specifically, quoting:

although the particular act which gives the cause of action may not be authorized, still if the act is done in the course of employment which is authorized, then the master is liable for the act of his servant.

So the corporation is a separate person and as lawyers we refuse to be involved in the philosophical questions this raises.

In this paper, however, I am not merely looking at corporations as legal structures to be put together and operated, I propose deliberately to introduce a third aspect, that of control. As a long-time observer of the non-profit sector, I hold that consideration of control must lead us inevitably to take at least one step in the philosophic moonscape of the corporate "group will". Like astronaut Neil Armstrong, I believe that one small step may in itself be significant.

Although I write as a lawyer and these remarks were originally addressed to lawyers, what follows is directed not just to the profession, but to all who are involved in, or concerned with, the welfare of non-profit organizations.

To introduce the subject, let me suppose (as occurred) that the Quebec Provincial Branch of the Canadian Bar Association entertained the Ontario Branch Council lavishly and hospitably. And the Ontario Council responded, at a later meeting, with a resolution expressing its gratitude for the munificence. Gratitude and munificence are hardly legal conceptions; they are emphatically qualities of persons. Are we to say then, that one personality, which has no existence outside the sphere of law, records its gratitude for the munificence displayed by another equally fictitious personality? (Courtesy, I hope, is not a fiction, legal or otherwise.) Or shall we say that the resolution is only a collective record of the individual gratitude of those (I fear few) members of the Ontario Council who stayed until this final resolution came up on the agenda? And how shall we attribute individual munificence to the members of a body whose gift was not derived from their private resources?

Certainly to the public at large, in which group we are not including lawyers, there is an attribution to the corporation of some very individualistic qualities. For example, when we speak of Imperial Oil being strongly supportive of charitable activity we are, we must admit, personifying the amalgam of decisions and present and past activities of a substantial number of directors, officers and employees into a single entity. We do, in fact, think of the corporation as a person. This has conceptual simplicity but procedural dangers.

The first danger is that where we do not like what Imperial Oil is doing—such as failing to reduce the pump price of gasoline to reflect the fall in oil prices—we immediately respond to this by turning for help to some outside person, be it the government-appointed oil controller or the police fraud squad.

Now apply this widely accepted reasoning to a non-profit corporation. Let us say we heartily disapprove of some action of the Canadian National Institute for the Blind. We do not stop to analyze the situation which might lead us to realize that an officer of this corporation is obviously exceeding his authority and so to a decision to report his behaviour to his superior. Instead, we immediately write the newspapers or the Public Trustee.

The second danger is that even though we are contributors to the CNIB and know that as a result we have status as voting members, we feel no sense of personal responsibility for the misbehaviour of the offending corporate individual.

I grade the likelihood of our possible responses as follows:

- i) stop contributing;
- ii) complain to some public authority;
- iii) complain to the switchboard operator;
- iv) attend and formally register our protest at the annual meeting when the members of the board will presumably have to listen.

The point I wish to emphasize is that having some formal status as a “constituent” of any organization in no way ensures that such a constituent will feel any obligation to exercise that function even assuming he or she recognizes that the role exists. This behaviour is characteristic of the constituents, i.e., shareholders, of large commercial corporations where the constituent shareholder has a personal financial interest. It is even more characteristic of constituents of non-share capital corporations where the role of most constituents is to *contribute* rather than *make* money.

I have already stated the belief, based on my own lengthy experience, that the strongest force keeping a non-share capital corporation alive to its environment and responsive to its opportunities consists of an informed and involved constituency, but I have not attempted to define that group. Some may feel it can be found in the board of directors. Personally, I deprecate the effectiveness of the board particularly if, as in many of the larger organizations, it is normal to limit terms of office to two or three years. Others might feel that the constituency can be found in the staff group. Again, I have considerable doubts, given the normal hierarchical structure which has been adopted from the business corporation model. It might be found in the working volunteers in the organization. It might be found in the clients of the organization. It might be found in some combination of one or more of these groups.

This is a problem which particularly affects charities, but it is certainly not

confined to charities. Yet in all the books on organization and management I have read over the years, I have found no mention of it as an issue.

All sorts of other management issues are discussed: ways to measure your market, to make your board more cohesive and effective, to make your staff more efficient, to keep your volunteers smiling and productive. We are overwhelmed by the disseminated “wisdom” of the Harvard School of Business and its imitators. Yet for all their vaunted expertise, none of the experts seems to have addressed the constituency problem. That problem is simply stated. I hope if nothing else, that this paper will make you aware of its importance and will encourage you to begin to seek within your own organizations for answers to these questions:

- Who should be our constituents?
- Have we recognized them and established their role?
- How do we keep them informed?
- Do they recognize their responsibility to the organization?
- Do they effectively influence our programs and policies?

This to my mind is the solution to the most difficult problem facing any corporation—its successful continuation after its successful incorporation and organization.

And if the organization fails, as many indeed do, it is the constituents who must accept the blame:

The fault, dear Brutus, is not in our stars  
But in ourselves that we are underlings.

The role of lawyers is too often conceived as restricted to the formalities—the legal niceties, the paper skeleton. I believe that role is far broader and more influential and I suggest that one of the most valuable ways in which lawyers could use this influence is to look beyond the traditional formalities to the care and nurture of the constituency.

Therein lies the ultimate success of any organization but particularly the charitable non-share capital corporation.