Towards a Reformed Non-Profit Corporations Statute[1]

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1. Introduction

Alberta Bill 54 of 1987, the *Volunteer Incorporations Act*, will regulate the incorporation and operation of Alberta non-profit corporations. It was introduced in the Alberta Legislature in June 1987, given first reading, and allowed to stand over for comment. The Legislature is expected to enact a revised version when legislative time can be found for it.

2. Existing Law of Alberta

In Alberta, incorporators who can attract the benevolent attention of the legislator can incorporate under various special statutes if their purposes fit within certain specialized criteria, e.g., to hold land for a religious group or cemetery or to form a co-operative. Similar choices are available in other jurisdictions.

Alberta, however, may well be unique in one respect. For historical reasons, an ordinary run-of-the-mill non-profit group in Alberta may choose to incorporate under any one of three statutes: the *Societies Act*, the *Companies Act* or the *Business Corporations Act*. None of these acts, however, is satisfactory for non-profit corporations in Alberta at the present time. The *Societies Act* of 1924, which is essentially the *Societies Act* of 1987, replaced and effected some modernization of Territorial ordinances dealing with benevolent and provident societies and with mechanics' literary societies. It is sketchy and leaves many legal questions unanswered. The *Companies Act* of 1929 has, over the years, become a patchwork of old and new ideas and drafting styles. It was designed primarily for business corporations and has been declared obsolete and replaced by the *Business Corporations Act*. However, the drafters of the *Business Corporations Act* designed that statute exclusively for business corporations and consciously put aside consideration of the needs of non-profit corporations. Something better than any of these is needed.

3. Development of the Proposed New Statute

The Alberta Institute of Law Research and Reform functions as a provincial law reform commission. It is a joint venture of the Government of Alberta, the Law Society of Alberta and the University of Alberta and has a connection with the University of Calgary as well. Its offices are located in the University of Alberta's Law Centre. In its business corporations and non-profit corporations projects it has worked in consultation with the Department of Consumer and Corporate Affairs as well as members of the bar and other

consultants and it has also received much drafting assistance from the Legislative Counsel's office.

In March 1987, the Institute issued its Report No. 49, *Proposals for a New Alberta Incorporated Associations Act.* This was the sequel to its Report No. 36, *Proposals for a New Business Corporations Act for Alberta,* upon which the 1981 *Business Corporations Act* (Alberta) is based. Bill 54 is based on Report No. 49 and much of it is reproduced verbatim from the draft bill attached to that report. (The Institute had found business corporations quite enough to cope with in Report No. 36 and, by agreement between it and the government, the old *Companies Act* has been left in force until something can be done about the non-profit companies incorporated under it.)

4. Basic Policy

Bill 54 is intended to provide efficient machinery for the incorporation and operation of non-profit corporations. It is not intended to go further. In particular, it is not intended to regulate charities as such, though, as I will note later, it does distinguish in some ways between non-profit corporations which solicit money from the public or from governments and non-profit corporations which do not. It is not intended to reward good conduct by conferring the benefits of incorporation nor is it intended to punish bad conduct by denying those benefits.

Bill 54 would bring under one statute all kinds of non-profit corporations which do not require special treatment for some reason of public policy. It does not distinguish among charitable non-profit corporations, religious non-profit corporations, non-profit corporations formed to promote other causes which their members think should be promoted, or non-profit corporations formed for the mutual benefit of their members. It is the Institute's view that one statute of general application to non-profit corporations is better than a series of more specialized statutes.

A specialized statute might be a shorter statute. Bill 54 will replace a 34-section, 11-page *Societies Act* with a 175-section, 75-page *Volunteer Incorporations Act.*[2] Is this progress? The Institute thinks that it is and so far the government has agreed with it. The Institute believes that the small unsophisticated non-profit corporation will be able to operate under the proposed statute as easily as it can under the *Societies Act* and that non-profit corporations of all kinds, sophisticated and unsophisticated, will be able to find many more answers, and many better answers to their problems, in the proposed statute than they can find in the existing ones.

5. Specific Policies

(a) *Relationship to the* Business Corporations Act[3]

Bill 54 uses many of the concepts and terms of the *Business Corporations Act* for two reasons: the one of lesser importance is that harmony between the two statutes will improve efficiency, particularly for those who must master or deal

with both. The second is that the *Business Corporations Act* is modern legislation about corporations and much of it is appropriate for modern non-profit corporations. Where the *BCA* does not meet the needs of non-profit corporations, however, Bill 54 departs from it without hesitation.

(b) *Relationship to Another Canadian Model*

In 1979, Saskatchewan enacted *The Non-Profit Corporations Act*, 1979 ss. c. N-4.1. This is based on a Canada Non-Profit Corporations Bill, the last formulation of which was Bill C-10 of 1980. That bill was developed from *Proposals for a New Not-For-Profit Corporations Law for Canada,* a document issued by the federal Department of Consumer and Corporate Affairs in 1974. These proposals were a companion piece to the proposals which led to the enactment of the *Canada Business Corporations Act* but they have not yet led to federal legislation.

The Saskatchewan statute is in place and functioning and there is no reason to doubt that it is a successful piece of legislation. Since the copying of legislation has a long and sometimes honourable history in Canada, this assessment suggests that Alberta could have saved itself much time and trouble by copying chapter N-4.1. The Alberta Institute of Law Research and Reform, however, thought that it would aim for a somewhat lighter harness and that it would try to develop some different concepts which would be useful for the kinds of non-profit corporations which incorporate in Alberta. There is a family resemblance between Bill 54 on the one hand and Bill C-10 and chapter N-4.1 on the other but there are significant differences.

(c) *Corporate Purposes*

Under Bill 54, incorporators, as of right, will be able to become incorporated for any purpose. The bill does not require the purposes of an incorporated association to fall within specified classes as do the *Companies Act* and the *Societies Act.* The Registrar of Corporations will not be able to decline to issue a certificate of incorporation as the *Societies Act* allows but will only be able to insist on receiving the documents and fees prescribed by law.

It follows that anyone who *can* associate will *be able* to associate in corporate form. A business corporation will be able to incorporate under the bill if it is willing to forego distribution of income or property to its members except upon liquidation. So will an association formed for objectionable purposes. Bill 54 is deliberately designed for the sole purpose of providing machinery for the incorporation and operation of corporate entities. It will be for the general law to say whether an incorporated association *can* act to carry out its purposes.

Bill 54, like the *Companies Act* and the *Societies Act,* does provide that incorporators must state the purposes of incorporation. This requirement has, however, nothing to do with the granting or withholding of incorporation under the proposed statute, its function is to allow those who have an interest

in an incorporated association to confine the association to its stated purposes.

(d) *Classification of Incorporated Associations*
Bill 54 does not classify incorporated associations as "charitable" corporations and "membership" corporations as Saskatchewan's *Non-Profit Corporations Act* does and as federal Bill C-10 would have done. The drafters thought that the definition would be difficult to understand and apply. They also thought that it would lead to difficulties in cases such as service clubs and religious and ethnic organizations which have some public benefit purposes and some membership benefit purposes.

Bill 54 will, however, require incorporated associations to classify themselves in one way. It will do this by requiring every incorporated association to adopt, by its articles of incorporation, one of the following restrictions upon the distribution of its income and property:

(i) *Income Distribution Restriction,* under which the incorporated association will not be able to distribute income or property to its members, directors or officers except upon the liquidation of the association. This is similar to the prohibition against the payment of dividends which is contained in the *Societies Act,* though it is articulated somewhat more fully. An association is likely to adopt this restriction unless it is established for a purpose which is intended to benefit the public.

(ii) *Income and Liquidation Restriction,* under which the association will never be able to distribute income or property to its members, directors, or officers, even upon liquidation, since upon liquidation, the property of the association will have to be used for a purpose similar to a purpose of the association as determined by the articles of incorporation or by the court. An association established for charitable or public benefit purposes is likely to adopt this more stringent restriction but it will be for the association itself to choose.

The requirement that an incorporated association have one kind of distribution restriction or the other in its articles of incorporation is new. However, the *Societies Act* already prohibits an incorporated society from declaring a dividend or distributing its property among its members during the existence of the society, and the *Companies Act* requires a non-profit company to satisfy the Registrar that it is the intention of the association to use the profits, if any, or any other income of the association, in promoting its objects. Furthermore, a non-profit corporation must have an income-and-liquidation distribution restriction if it wants to be exempted from corporation tax or to be given the status of a charity under the *Income Tax Act.* The new requirement is therefore consistent with the existing law and practice.

(e) *Consequences of the Different Restrictions*
Bill 54 will give the force of law to either an income restriction or an income-and-liquidation restriction. It will require the property and profits of an association to be used to further the activities of the association. Upon liquidation, it will require that the property of an incorporated association which has an income-and-liquidation restriction be used for a purpose similar to a purpose of the association. It will give an association the right to recover from members, directors and officers any property paid or transferred in contravention of these provisions. It will prohibit an association which has adopted the income-and-liquidation distribution restriction from removing that restriction.

The principal purpose of providing for the two kinds of restriction is to make it clear to incorporators and members of any association whether an incorporated association is incorporated for their benefit or for some perceived public benefit or other external purpose. If the purpose of the members is to benefit themselves, they will presumably choose an income restriction. If their purpose is to benefit the public or some segment of it they will presumably choose an income-and-liquidation restriction. They will thus be able to participate in an incorporated association's activities with the certain knowledge that the purpose is one thing or the other.

Apart from these obvious consequences, Bill 54, with one minor exception, does not distinguish between associations on the basis of the two different restrictions. It does, however, make one further distinction.

(f) *Incorporated Soliciting Associations*
Bill 54 makes some specific provisions about "soliciting" associations, i.e., incorporated associations which, in the given financial period or in one of the three preceding financial periods, have solicited money from the public or have received a grant from any level or agency of government. These specific provisions are:

(i) a "prescribed" soliciting association will be able to change its purposes only with the permission of the court;

(ii) a "prescribed" soliciting association will have to have at least three directors instead of one;

(iii) a "prescribed" soliciting association will have to file its financial statements with the Registrar of Corporations;

(iv) a "prescribed" soliciting association will not be able to dispense with an auditor or, in lieu of appointing an auditor, to appoint a member of the association to examine the books and report on them;

(v) a "prescribed" soliciting association will have to circulate its financial statements 21 days before its annual meeting.

The term "solicited from the public" is to be defined by regulation and regulations will also say which associations are to be regarded as "prescribed" soliciting associations. An assessment of the impact of the special provisions mentioned above will, therefore, have to await the promulgation of regulations.

These special provisions will not regulate charities as such, though most soliciting associations will probably be charities or other public benefit associations and they will not provide for any significant regulation of the associations to which they apply. This is in accordance with the basic policy of Bill 54. They will, however, recognize a public interest in the handling of money received from the public whether directly, through solicitation, or indirectly, through governments. They will also give some modest protection to public money and require a modest degree of public disclosure.

The *Societies Act* requires every incorporated society to file financial statements with the Registrar of Corporations each year so Bill 54 will relieve most of them of an existing requirement. It will also relieve the Registrar of the obligation of receiving and storing a good deal of material which is really of little concern other than to the members of the incorporated societies themselves. The *Companies Act* does not require the filing of financial statements except by public companies.

(g) *Incorporation Procedure*

The procedure for incorporation under Bill 54 will be much the same as it is under the *BCA*. One or more incorporators will be entitled to send articles of incorporation, notices of directors and a registered office, and the proper fees to the Registrar of Corporations and to receive a certificate of incorporation in return.

The name-search procedure will be much the same as that under the *BCA*. An incorporated association's name will not be able to include "Limited" or any of the other words which are the badges of incorporation under the *BCA* and the name of every new incorporated association will have to end with "Incorporated Association" or the abbreviation "IA" which, after an initial period of confusion, will come to be recognized as a badge of incorporation under the proposed act.

(h) *Effect of Incorporation*

Like a business corporation under the *BCA*, an incorporated association will have the capacity of a natural person. This is intended to get away from the doctrine of "limited corporate powers", which under the *Societies Act* and the *Companies Act*, applies to societies and non-profit companies.

An incorporated association will have to state its purposes in its articles of incorporation and Bill 54 provides that it shall not carry on its activities or exercise its powers except for those purposes. There is some concern that these provisions will bring the doctrine of "limited corporate powers" in through the

back door but the view of the drafters is that it will not. The provision which will confer full capacity will override the provision which will require the purposes to be stated and the Bill provides that an act of an incorporated association is not invalid by reason only that it is contrary to the association's articles or to the proposed act.

The *BCA* allows a business corporation to include in its articles of incorporation a restriction upon what the corporation can do. A statement in Bill 54 that an incorporated association is restricted from carrying on activities which do not fall within its purposes does not seem more likely to restore the doctrine of limited powers than is a statement in the articles of incorporation of a business corporation that the corporation is restricted from carrying on activities specified in the articles. It is, in fact, believed that Bill 54 will effectively abolish the doctrine of limited powers.

Bill 54 embodies provisions about the internal management rule which are much the same as the provisions in the *BCA*. No one without actual knowledge of a document filed with the Registrar or at the association's office will be affected by what it is in the document and no one without actual knowledge or a special relationship to the association will be affected by the association's failure to comply with its articles of incorporation or by-laws or by defects in the appointments of association officials. Outsiders will be able to rely upon appearances.

6. Constitution and Organization of an Incorporated Association

(a) *Constitution*

The constitution of an incorporated association will consist of articles of incorporation and by-laws. This will bring incorporated associations into line with business corporations (though a business corporation can do without by-laws if it is content with the provisions of the *BCA*).

As is the case of a business corporation under the *BCA*, the articles of incorporation will give an incorporated association its fundamental characteristics: name, purposes, restrictions upon distribution of property and income, and classes of members.

Bill 54 is somewhat more paternalistic about by-laws than is the *BCA*. It requires the affairs of an incorporated association and the manner in which the association carries on its activities to be regulated by by-law. Regulations will prescribe standard by-laws. An association will be able, however, to adopt its own by-laws which will supersede the standard by-laws. These provisions are intended to achieve two objectives: to provide an unsophisticated association with an adequate set of ground rules and to leave every association, sophisticated or unsophisticated, free to decide how to run its own affairs.

Unlike the *BCA*, Bill 54 provides that no by-law or repeal or amendment of a by-law will have effect until it is sent to the Registrar of Corporations. This filing requirement will impose a burden upon the Registrar and upon

incorporated associations though it is a burden which is already imposed upon societies and non-profit companies by the existing statutes. The justification for the burden is that it is desirable that there be a public record from which the legally effective ground rules applicable to incorporated associations (whose record-keeping is likely to be subject to discontinuity), can be ascertained. The standard by-laws prescribed by regulation will govern, except to the extent that filed amendments change them, and a search at the Corporate Registry will disclose any by-laws which supersede the standard by-laws.

Bill 54 provides that by-laws are to be adopted by the members of an incorporated association by special resolution. This follows the *Societies Act* and the *Companies Act.* It does not follow the *BCA*, under which the directors adopt by-laws and the shareholders approve them. Adoption by the members emphasizes control by the membership, which seems appropriate for non-profit organizations.

(b) *Membership*

The articles of incorporation of any incorporated association will deal with classes of members and the by-laws will deal with admission to membership, transfer of membership (memberships being non-transferable unless the by-laws otherwise provide) and termination of membership (though a member will have a statutory right to resign from membership). Bill 54 provides that, except for termination for non-payment of fees or because of lapse of time, an incorporated association can terminate a membership only in accordance with the rules of natural justice.

Bill 54 will allow an incorporated association to have share capital. Most associations will not want share capital but there seems to be no sufficient reason why those which do want it should not have it. For example, some private clubs find share capital convenient and so do some individuals who establish private charitable foundations and find shares a useful vehicle for passing on control. Rather than clutter itself up, Bill 54 incorporates, by reference, for share capital associations, the provisions of the *BCA* relating to share registration and transfers and to financial matters.

(c) *Directors*

Bill 54 will require an incorporated association to have one or more (or, in the case of a prescribed soliciting association, at least three), directors. It provides that the directors shall manage the affairs of the association. To this point, it resembles the *BCA.* Its provision that the directors shall manage is, however, made subject to the articles of incorporation and the by-laws of the association, so that an association which wants a different form of organization will be able to have it. However, such an association will have to show on its annual return those who "occupy the position of director".

Bill 54 does not prescribe any qualification for directorship other than a qualification that only individuals can be directors. It will leave everything

about the election and removal of directors to the by-laws (including the possibility of cumulative voting), except that it will limit the term of a director to three years, require election by the members (apart from some provisions for appointment of directors by the directors), and provide that the members may remove a director by ordinary resolution at any time.

Bill 54 will impose duties and obligations upon directors in much the same terms as does the *BCA*. These include the duty to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". The drafters were concerned lest it be unfair to volunteer directors to expose them to liability under such a high standard. They concluded, however, that an accessible statutory provision is likely to be more in the interests of directors, as well as others, than a vague and inaccessible common-law duty which, according to some views of the law, may sometimes turn out to be more onerous that the statutory duty.

Bill 54 will do something more for the volunteer director. It will allow a court, "if it appears that the director or officer has acted honestly and reasonably and ought fairly to be excused", to "relieve the director or officer either wholly or partly from liability for" a breach of the duties which will be imposed by the statute. This is similar to provisions of the *Trustee Act* which allow a court to relieve a trustee of liability.

Bill 54 also follows the *BCA* provisions about indemnities for directors. Directors of non-profit corporations with substantial assets and activities have expressed considerable concern about their potential liability and the *BCA* indemnity provisions seemed to be appropriate for non-profit corporations as well as business corporations.

The *Companies Act* imposes some liability upon directors for employees' wages, as does the *BCA* but the *Societies Act* does not and Bill 54 will not. The *Societies Act* position seems more appropriate for volunteer directors and employment standards legislation, which deals with the subject of directors' liability for wages, is a better place to deal with the matter.

7. Members' Remedies

Bill 54 will import, from the *BCA,* some remedies which will be new to non-profit corporations. However, although the bill makes some changes in the specific provisions, the pattern is much the same:

(i) *Investigation.* If there is reason to believe that an incorporated association's affairs are being carried on fraudulently, dishonestly or oppressively, the Court of Queen's Bench will have power to appoint an inspector to investigate and report back to the Court. Any member, or any person who has been a member within the preceding year, can apply for such an investigation, as can the Registrar of Corporations, who appears to be the most appropriate official to have this power. The Attorney General's *parens patriae* power to supervise charities is not touched by Bill 54 but is rarely used. An investigation will not in

itself offer a remedy to an aggrieved member of an incorporated association but it may provide facts with which such a member can take legal action.

(ii) *Derivative Action.* The Court of Queen's Bench will have power to authorize a member, former member, director or officer of an incorporated association to bring or defend an action on behalf of the association. However, the directors must first have been given an opportunity to act and the proposed action must appear to be in the best interests of the association. If those in control of an incorporated association do the association injury or connive at injury being done to it, the derivative action will enable the association's members to seek, and obtain, redress.

(iii) *Compliance Order.* The Court of Queen's Bench will have power to order anyone involved with an incorporated association—directors, officers, members, auditors, receivers, liquidators—to comply with the new statute, the regulations under it, and the articles of incorporation and by-laws of the association.

(iv) *Right to Dissent.* The *BCA* allows a shareholder of a business corporation to object to certain kinds of fundamental changes in the structure and business of the corporation and to require that his or her shares be bought out at fair market value if the corporation proceeds to make the change. In many incorporated associations there will be nothing to buy out and in most of the rest a member's economic interest will not be enough to justify this extra restraint. However Bill 54 will confer this right if the incorporated association has share capital.

Bill 54 will not confer on the members of an incorporated association the *BCA* remedy under which a shareholder can sue for relief on the grounds of oppression. The drafters are of the view that, given the members' lack of economic interest in most non-profit corporations and the lesser magnitude of such interests in most of the rest, the possible detriment to corporate activities which the existence of the oppression remedy would impose is not justified.

8. Some Other Matters

The provisions in Bill 54 regarding liquidation are much the same as those of the *BCA* which has procedures which are suitable for both complicated and uncomplicated cases. Bill 54 provides for the amalgamation of incorporated associations and for their legal migration from one jurisdiction to another. Amalgamation and migratory continuance are not likely to be needed often but there have been cases in which they would have been helpful. Bill 54 will deal with the registration of extra-provincial non-profit corporations but will make little change in the law in that respect, though it will terminate some old exemptions from the requirement of registration.

9. Existing Societies and Non-Profit Companies

The Canada *BCA* and most of its provincial counterparts, including the Alberta *BCA,* required existing business corporations to "continue" under the

new statutes. However, "continuance" looked very much like re-incorporation and also involved significant cost. The institution of a significant new set of corporate ground rules was regarded as important enough to justify the cost and it was felt that merely imposing the new ground rules on existing corporate constitutions might well have caused future confusion as well as unacceptable damage to some of the important economic interests which are involved in business corporations.

Non-profit corporations are different. In most of them there are no conflicting economic interests which will be affected by new ground rules and those interests there are are not usually of comparable magnitude. Some non-profit corporations are sophisticated in business matters and have access to professional advice and the funds to pay for it but imposing the trouble and cost of "continuance" on most would cause unjustifiable hardship. There is also a possibility that it might cause organizations which are properly incorporated and, therefore, should not be interfered with, to surrender their incorporations.

The new statute will apply to existing societies and non-profit companies as it finds them. It will declare that the "memorandum of association" of a non-profit company is the articles of incorporation and that the "articles of association" are the by-laws. It will declare that the application for incorporation of a society is the articles of incorporation and that the by-laws of the society will continue to be the by-laws. It will provide that certain things in the existing constitutional documents are the counterparts required by the new act: name, objects or purposes, restrictions on activities, and membership provisions. If the constitutional documents do not contain either an income restriction or an income-liquidation restriction on distribution of property as required by the new statute, the articles of incorporation will be deemed to include an income restriction.

10. Conclusion

Most incorporated associations will carry on their affairs under the new statute much as they are carrying on their affairs now. There will not be any additional bureaucratic requirements or onerous regulation and most will be relieved of the burden of filing financial statements with the Registrar of Corporations every year. Official explanatory material will, for most purposes, protect them from ever having to read the new statute.

Associations which would have incorporated under the *Companies Act* will find the proposed new forms simpler. Incorporators will have to direct their attention to what will happen to their incorporated association's assets when the association is dissolved but most incorporators do that now and those who do not should do so.

Those who need legal answers to questions about non-profit corporations will be more likely to find them in the proposed new statute. Members will have new remedies. Incorporated associations which want to do unusual

things such as amalgamating or migrating will be more likely to be able to do them.

Finally, incorporation law will be brought into one statute; those who deal with Alberta corporations will not have to remember one set of laws for societies and a second for non-profit corporations. Those who are familiar with either the *BCA* or the new statute will be able to read the other statute without difficulty and will be able easily to discuss the similarities and differences.

FOOTNOTES

1. The author suggests the reader should be aware that he has been closely associated with the development of Bill 54 and with the Institute of Law Research and Reform.
2. It should be remembered that Bill 54 will also replace a 316-section, 157-page *Companies Act.* There will thus be a net saving of more than 90 pages in the statute book.
3. The *Business Corporations Act (Alberta)* is patterned after the *Canada Business Corporations Act.* Although many readers are doubtless familiar with one of the group of similar acts, it is hoped that this discussion will be intelligible to those who are not.