Reform of the *Canada Corporations Act*: Draft Framework for a New *Not-For-Profit Corporations Act*

NATIONAL CHARITIES AND NOT-FOR-PROFIT LAW SECTION
CANADIAN BAR ASSOCIATION

December 2003

TABLE OF CONTENTS

Reform of the *Canada Corporations Act*: Draft Framework for a New *Not-For-Profit Corporations Act*

PREFACE

The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Charities and Not-For-Profit Law Section with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the Charities and Not-For-Profit Law Section of the Canadian Bar Association.

Reform of the *Canada Corporations Act*: Draft Framework for a New *Not-For-Profit Corporations Act*

I. INTRODUCTION

This submission provides the preliminary commentary of the National Charities and Not-for-Profit Law Section of the Canadian Bar Association (the CBA Section) on Industry Canada's (Corporate and Insolvency Law Policy Directorate, Policy Sector) proposed reform of the *Canada Corporations Act*.

The CBA Section welcomes the proposal to reform the *Canada Corporations Act*. A reformulation and fundamental re-thinking of the Act is long overdue. The proposal promises to provide the sector with a state-of-the-art corporation law.

The commentary on the proposed framework is divided into three parts. Part I comments on and follows the organization of the document, *Reform of the Canada Corporations Act: Discussion Issues for a New Not-For-Profit Corporations Act - A Supplement to the Draft Framework* (*"Supplement"*). Part II comments on other issues arising in the more detailed document, *Reform of the Canada Corporations Act: Draft Framework for a New Not-For-Profit Corporations Act* (*"Draft Framework"*). Part III offers brief suggestions on topics not addressed in the framework proposal.

II. ISSUES RAISED IN THE SUPPLEMENT

1. Objective of Reform

The CBA Section agrees that the principles of the reform should include flexibility and permissiveness, transparency and accountability, efficiency, and fairness. We would add that the overall objective should be a statute that provides a workable and easily used basic constitutional law for not-for-profit organizations that choose to incorporate. This, we believe, is the single overriding objective. A good corporate law should be responsive to the needs of its users. It should provide basic constitutional rules that are appropriate for the social reality of these organizations and for their purposes. It should provide the appropriate imperative and suppletive rules expressed at the appropriate level of generality.

The framework proposal is correct to eschew inclusion of regulatory law in the basic organizational law. Only matters pertaining to organizational law should be addressed in the corporation statute. However, statutory provisions that articulate and address enforcement of the main elements of the fiduciary obligations of the fiduciaries of non-profit corporations — duty of loyalty, duty of skill and diligence, self-dealing and conflicts of interest — are not regulatory law, as the proposed framework appears to suggest in several places. These matters, rather, are central to the proper articulation of an organizational law. The new statute should address the basic elements of the law governing directors and officers, including rules dealing with conflicts of interest.

Success in the achievement of the varied goals of the proposed framework can be fully evaluated only once the proposed new law is drafted. The appropriateness of the new statute is largely a function of its accessibility and ease of use. Accessibility and ease of use are partially a function of its conceptual

underpinnings, which are addressed in the framework proposal, and partially a function of its style and manner of expression, which, of course, are not. We await a draft statute.

2. Classification Scheme

The draft framework opts for a statute that will not use a classification scheme.

It remains to be seen whether, in the actual drafting of the legislation, the absence of a classification scheme makes the statue simpler and more accessible. The American experience with the *Revised Model Act* of the American Bar Association and the California *Corporations Code* suggests that a classification scheme is indispensable. Older American and Canadian statutes use a single set of rules for all non-profit corporations. The American Bar Association committee that drafted the *Revised Model Act* came to the conclusion that the lack of a classification scheme was a major deficiency in the older American statutes. There is a significant difference, for example, between a public benefit (or charitable) organization and a mutual benefit organization.

Regardless of whether the proposal explicitly adopts a classification scheme, one would expect the statute to reflect important distinctions in the different types of organizations in a number of its rules. For ease of expression, this commentary will use (without necessarily advocating) the *Revised Model Act*'s classification of mutual benefit, public benefit (or charitable) and religious. The *Revised Model Act* does not define these terms. There may be no need to do so. The distinctions among these three types might or should be reflected in the following rules, most of which would be suppletive:

- On dissolution, the assets of a charitable corporation should go to another charitable corporation, whereas the assets of a non-charitable corporation would often be distributed to the members or to other non-charitable non-profit corporations with similar objects.

- Membership in a charitable corporation typically would not be transferable. Membership in a mutual benefit typically would.

- Membership in a charitable corporation typically would not be capable of purchase by the charitable corporation. Membership of a mutual benefit corporation typically would.

- The membership interest of a member of a mutual benefit corporation is often pecuniary or quasi-pecuniary in nature and, arguably, members of a mutual benefit corporation will be entitled to greater member rights, such as governance rights, dissent and appraisal rights, derivative action rights, oppression remedy rights and a process of dismissal that complies with the rules of natural justice.

- Similarly, members of a mutual benefit corporation, because of their pecuniary or quasi-pecuniary interest, would typically have greater rights when the corporation seeks to amend its basic constitutional law.

- There should be prohibitions against, or at least restrictions on, public benefit corporations merging or amalgamating with non-public benefit corporations or commercial corporations. Such mergers or amalgamations would probably be permitted without restrictions, subject to constitutional protections, in the case of mutual benefit corporations.

- The fiduciary obligations of directors and officers of charitable corporations should be higher than those of directors and officers of mutual benefit corporations.

- Religious organizations are distinct from other charitable and mutual benefit organizations by virtue of their already well-developed internal law, fundamental right to be free of government interference or supervision, extensive truth claims, and all-encompassing-meaning claims. Accordingly, religious corporations should be subject to fewer imperative rules.

The risk in failing to make the necessary distinctions at the outset is the adoption of inappropriate imperative rules and inappropriate suppletive rules, with the result that the statute fails to facilitate in the way intended.

3. Access to Financial Statements

The framework proposal suggests that not-for-profit corporations be required to make corporate financial statements available to members, directors, officers, and the Director under the statute.

We agree that this should be an imperative rule for all not-for-profit corporations. It responds to the basic logic of accountability — since the directors of the not-for-profit corporation are fiduciaries they must account to the beneficiaries of their fiduciary obligation. However, fiduciaries of mutual benefit corporations should have to account only to their members. Fiduciaries of public benefit corporations, on the other hand, should have to account to their members and to the same public agency, such as the Director, on the theory that the relevant public agency is a proxy for the public benefit corporation's purposes. There might, however, be a right in the Director to obtain financial statements on request.

4. Membership Lists

The framework proposal requires that membership lists, notice lists and voters lists be made available only to members, officers and directors of the corporation. It

contemplates a system of requiring a sworn statement setting out reasons for requesting a list. There are exceptions and a corporation can obtain an exemption from the requirement in some circumstances.

We agree that membership lists should only be made available to members who undertake by affidavit to use them for a proper purpose.

5. Standard of Care

The framework proposal advocates the adoption of a standard of care similar to that in the *Canada Business Corporations Act* (*CBCA*). This standard would require directors and officers of a not-for-profit corporation to act honestly and in good faith in the best interests of the corporation, to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances, and to comply with the act, articles and by-laws in any unanimous shareholder agreements.

A clearly stated duty of care and duty of loyalty would be a welcome improvement. The precise formulation of the duty of care and duty of loyalty should probably mimic the *CBCA*. The language in the *CBCA* is now well known and well understood.

6. Due Diligence Defence

The framework proposal suggests that the new not-for-profit corporations law include a due diligence defence for directors and officers of not-for-profit corporations.

This is a sensible innovation.

7. Filing By-laws

The framework proposal suggests that corporations be required to file by-laws with the Director, but that the Director be given no authority to approve or disapprove the by-laws.

By-laws should be effective upon confirmation by members. The requirement to file by-laws should be dispensed with. However, it might be useful if by-laws could be filed on an optional basis.

8. Natural Justice and Fair Procedures

The framework proposal suggests that the new not-for-profit corporations law not include provisions for natural justice.

For organizations where the member has a pecuniary interest in their membership, it would seem that the appropriate suppletive rule (if not imperative rule) is that the membership not be revoked without some sort of fair and reasonable fact-finding process. The not-for-profit corporations statute should therefore offer a formulation of the rules of natural justice on a suppletive, if not imperative, basis for mutual benefits corporations.

9. Dissent Right and Appraisal Remedy

The framework proposal suggests that there not be any dissent rights or appraisal rights for members in the new *Not-For-Profit Corporations Act*.

The previous comment applies here. Some dissent and appraisal right is advisable for mutual benefit corporations where the members have a pecuniary interest, at least on a suppletive basis.

10. Audit Requirements

The framework proposal suggests that not-for-profit corporations with gross annual revenues of more than $250,000 undertake an audit and make the audit results known to their members.

This is a sound proposal.

11. Oppression Remedy

The framework proposal recommends that there not be an oppression remedy.

An oppression remedy makes sense for a mutual benefit corporation.

12. Derivative Action

The framework proposal suggests that there not be derivative action in the new act.

A derivative action makes sense for a public benefit corporation and a mutual benefit corporation.

13. Modified Proportionate Liability

The framework proposal suggests that a modified proportionate liability regime not be included because it is inappropriate for not-for-profit corporations.

We agree with this recommendation.

III. COMMENTS ON THE DRAFT FRAMEWORK

1. Single Director and Corporate Applicant

The framework proposal suggests that only one director be required and that an applicant for incorporation can be a corporation.

The proposal for a single first director is a useful innovation. However, the proposal for a corporate applicant, especially in regard to charitable corporations, seems inappropriate in light of the heightened fiduciary obligations of the directors of charitable corporations.

2. Unanimous Member Agreements

The framework proposal contemplates members entering into unanimous member agreements in which some or all of the powers and rights of the directors of the not-for-profit corporation are constitutionally delegated to members.

This may be a reasonable innovation for mutual benefit corporations but probably should not be allowed in the case of charitable corporations on account of the heightened fiduciary obligations of directors of charitable corporations.

3. Election of Officers

The framework proposal allows only directors to elect officers. Currently, members can also elect officers.

It would be preferable to allow members to elect officers as well. Many organizations, for example, allow the membership to elect the president.

4. Members Proposals

The framework proposal suggests a "member proposal" right. Members would have the right to have certain matters raised at a meeting and a member could force the corporation to include a proposal in a notice of meeting by applying to the court for an order delaying the meeting.

This right is more suitable for mutual benefit corporations where the members have a pecuniary interest. In a public benefit or charitable corporation it may lead to undue political turmoil.

5. Members Rights on a Constitutional Change

The framework proposal suggests that all members of all classes, including non-voting classes, approve amalgamations.

Since there are many situations where non-voting members will have no pecuniary interests, it does not make sense to involve them in the approval of constitutional changes, especially in the case of charitable corporations.

IV. MATTERS NOT RAISED IN THE DRAFT FRAMEWORK

The proposals do not contemplate any of the distinctive governance structures and affiliation structures in the sector such as self-perpetuating boards, federated charities and associated foundations. A good suppletive law should address common structures.