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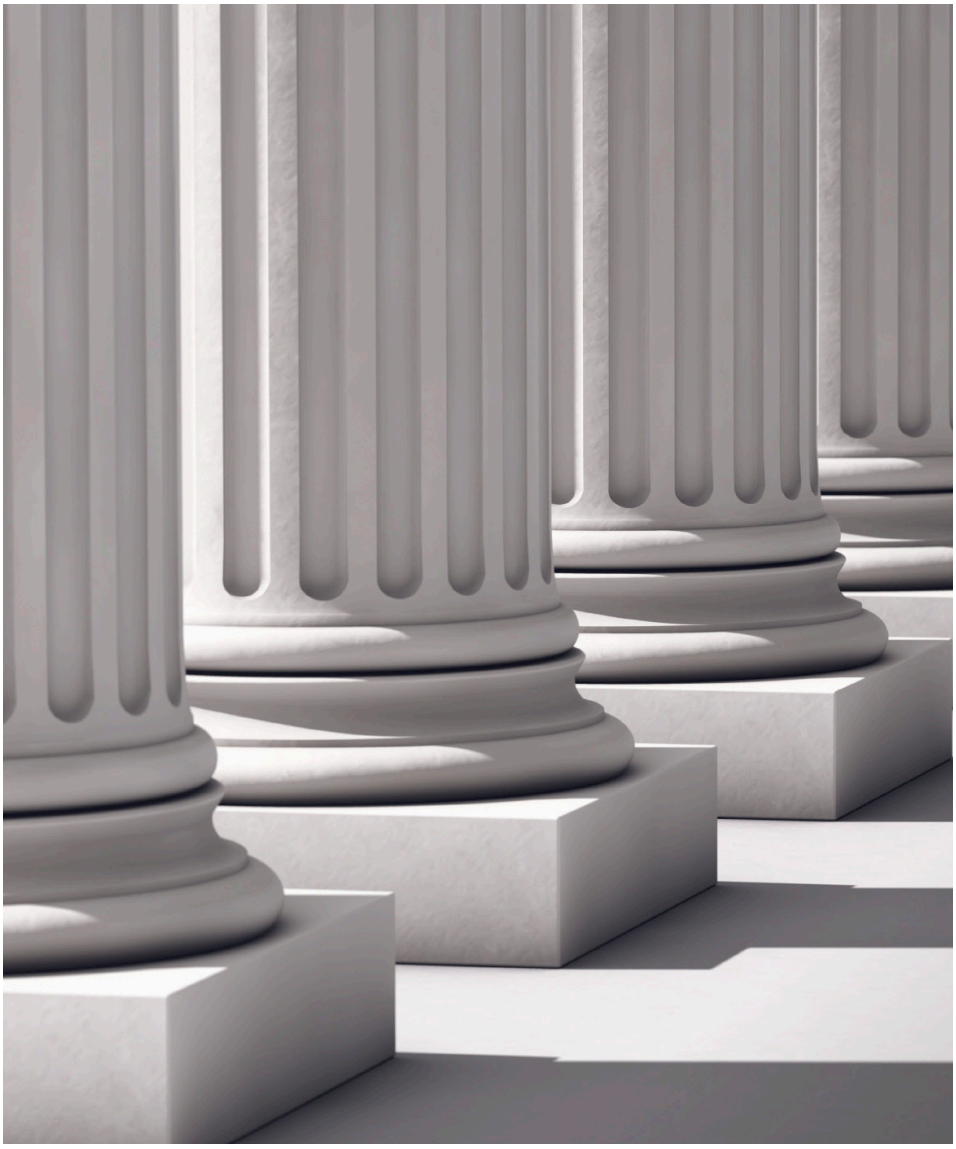
INSTITUTE

NON-PROFIT CORPORATIONS



REPORT FOR DISCUSSION

26

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Invitation to Comment

Deadline for comments on the issues raised in this document is May 1, 2015

This Report for Discussion by the Alberta Law Reform Institute (ALRI) proposes the creation of a new statute covering all non-profit organisations. It sets out proposals including, incorporation, membership, management and financial reporting.

The purpose of issuing a Report for Discussion is to allow interested persons the opportunity to consider these proposals and to make their views known to ALRI. You may respond to one, a few or all of the issues raised. Any comments sent to us will be considered when the ALRI Board makes final recommendations.

You can reach us with your comments or with questions about this document on our website, by fax, mail or e-mail to:

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Law reform is a public process. **ALRI assumes that comments on this Report for Discussion are not confidential.** ALRI may quote from or refer to your comments in whole or in part and may attribute them to you, although we usually discuss comments generally and without attribution. If you would like your comments to be treated confidentially, you may request confidentiality in your response or you may submit comments anonymously.

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Alberta Law Reform Institute

The Alberta Law Reform Institute (ALRI) was established on January 1, 1968 by the Government of Alberta, the University of Alberta and the Law Society of Alberta for the purposes, among others, of conducting legal research and recommending reforms in the law. Funding for ALRI's operations is provided by the Government of Alberta, the University of Alberta and the Alberta Law Foundation.

ALRI reports are available to view or download from our website at:

www.alri.ualberta.ca

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Acknowledgments

This Report for Discussion marks an important stage in the development of new non-profit legislation for Alberta. The current legislation, the *Societies Act*, is almost 100 years old, and Part 9 of the *Companies Act* was a leftover from the introduction of business corporation legislation in the early 1980s.

The Institute has consulted broadly on this topic. A discussion paper was prepared for one of the Muttart Foundation's intensive policy seminars. A survey was also completed by over 300 non-profit organizations. All of this input was considered and fed into our proposals.

In order to ensure that we have the broadest level of input possible, we have prepared a formal Report for Discussion for one last round of consultation. We have been ably assisted in this process in several ways. Our Expert Advisory Group has provided crucial knowledge and analysis, and assistance with the various consultation documents. This group consists of:

John C. Armstrong, QC Armstrong Estate Law
Peter Broder, The Muttart Foundation
C. Yvonne Chenier, QC, Drache Aptowitzer LLP
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Ruth M. Spetz, Borden Ladner Gervais LLP

We thank them for both their time and insight. Our Sector Advisory Group has provided practical, on the ground advice, and assisted with the dissemination of questionnaires, to ensure that we have feedback from a broad spectrum of non-profit organizations.

Our first discussion paper was jointly written by former counsel Maria Lavelle, and current counsel Geneviève Tremblay-McCaig. Their subsequent research and consultation contributes significantly to this document. This Report for Discussion has been assembled and written by Geneviève Tremblay-McCaig, with assistance from the Director, Peter Lown. As always, the ALRI Board reviews and has provided insight and improvements to the overall document. I would also like to thank Jenny Koziar who has ensured that the report meets our format and style requirements.

Summary

The non-profit sector is an integral part of our economy, society and way of life. It is a growing component in the province-wide delivery of an array of services, such as education, training, housing, food banks, healthcare, and recreation.

As in other sectors, non-profit organizations must demonstrate and maintain levels of relevancy, adaptability, competency and efficiency in an increasingly challenging environment. One way to help non-profits keep pace with these demands is to provide an incorporation mechanism that will allow them to meet challenges as they arise.

More than ever, Alberta's non-profit sector needs clear and user-friendly legislation that:

- puts in place tools to help non-profit organizations accomplish their specific objectives,
- is flexible enough to accommodate the diversity of the non-profit sector and the changing circumstances of the organizations when needed,
- plainly articulates the roles, responsibilities and rights of both directors and members, and
- eliminates requirements that do not meaningfully advance the interests of stakeholders.

Non-profit organizations and regulators are often working within limited means. The balance between requirements and the ability to comply is crucial, so that human and financial resources can be dedicated to the objectives of the organization and to the appropriate role of the regulator. The first step in achieving such balance is not only to get input from non-profits themselves, but also from those who interact with these organizations, including corporate authorities, granting agencies and legal advisers.

To this end, the Alberta Law Reform Institute (ALRI) has worked in collaboration with representatives of various types of stakeholders to develop a better understanding of the issues each respectively deal with. As part of this consultation process, ALRI now releases a Report for Discussion. The Report contains a series of preliminary recommendations designed to provoke feedback in the following key areas.

Approach and Principles

A group of people with a common purpose may wish to formalize their operations into a legal structure. One option is to incorporate. In Alberta, organizations that operate for a purpose other than the monetary gain of their members may incorporate as a society under the Societies Act or a non-profit company under Part 9 of the Companies Act. While these two statutes provide mechanisms for incorporation, they lack guidance in a number of respects, especially the function of the stated purpose, the obligations of those running the organizations, the rights of those responsible for holding them to account, and how internal disputes should be dealt with.

ALRI recommends replacing the current *Societies Act* and *Companies Act* with a single act, which we believe will better serve organizations, their members and the general public as well. The new act should set out modern requirements for the governance structures of non-profit corporations. These requirements should apply to all corporations unless they adopt their own. Otherwise, we think that corporations should have the flexibility to adjust the operating environment to suit their specific needs and circumstances. Therefore, any matters that are not specifically regulated in the act should be left up to the corporations, including the choice to restrict their purposes, activities or powers in order to meet requirements of fundraising or tax legislation.

Incorporation and Capacity

An application for a certificate of incorporation should only require the submission of the articles of incorporation, the notice of directors, the notice of registered office, and the NUANS name search report. At a minimum, the articles should include the name of the corporation, a statement of purpose, a class of membership with voting rights, the minimum and maximum number of directors, an election respecting the distribution on dissolution, and any restrictions on the powers or activities of the corporation.

Corporations should not have to submit by-laws with their application to obtain a certificate of incorporation. However, the act should require that they be filed within the prescribed period of time after the members have confirmed them. As with articles, by-laws or amendments to by-laws should no longer be subject to the review and approval of the corporate authorities.

The function of the corporate authorities/regulators should be to make sure that the articles and by-laws include all required items, rather than to review and approve the content of those documents. Once incorporated, non-profit corporations will have all the powers of a natural person, unless otherwise provided in their governing documents. Corporations that wish to apply for tax-exempt status under the *Income Tax Act* will have the responsibility to

make sure that their governing documents include appropriate purposes and restrictions.

Funding is one of the biggest challenges facing organizations, which are often competing for a limited pool of money. Current legislation significantly restricts the ability of non-profit corporations to engage in activities that generate revenue surpluses or accretions, even when those activities are in support of their stated purposes. ALRI recommends that corporations be free to carry on "business" activities that are incidental or ancillary to their purposes as long as members do not personally profit financially from those activities.

Corporations should not be allowed to distribute assets directly to members during their existence as this is the key feature that sets non-profit corporations apart from for-profit corporations. However, to better accommodate member benefit corporations, especially existing Part 9 non-profit companies, ALRI recommends the establishment of a two-part model: (1) fully restricted corporations, and (2) partly restricted corporations. This two-part model will preserve the prohibition against asset distribution during existence for all corporations while giving organizations such as golf clubs the option to incorporate as partly restricted corporations, thereby having the ability to divide up remaining property on dissolution, with tax consequences.

Directors' and Officers' Duties and Liabilities

Non-profit corporations are expected to adopt sound governance standards for how they manage, operate and govern their organizations. ALRI does not propose to create new obligations for directors and officers. Rather, the objective is to draw attention to what is expected from those running non-profit corporations by including a list of the directors' and officers' duties and liabilities in the new act. Although case law provides some help, we think that additional guidance would be of great benefit in a sector where those who serve on boards are in most cases unpaid volunteers with variable degrees of expertise and experience. The act should also include specific rules for dealing with conflicts of interest, including material interest and dual loyalty issues.

While directors' and officers' personal liability remains an exception, ALRI recommends the introduction of mechanisms to further mitigate the risks of being held personally responsible for the actions or omissions of the corporation they serve, including a dissent procedure, a due diligence defence, and court relief from personal liability. Corporations should also be able to indemnify their directors and officers or purchase insurance to cover that indemnity, because exposing those individuals to personal liability when they are acting in good faith and within the authority granted by the incorporating statute and governing documents may make it more difficult to attract candidates into these roles.

Members' Roles and Rights

Members have primary responsibility for holding non-profit corporations to account. With that should come a number of entitlements which enable them to fulfill that responsibility, including the right to access corporate information, to attend meetings of the members, to elect and remove directors, to approve key amendments to governing documents and fundamental changes, to ensure that corporate powers are used in furtherance of the stated purposes, and to submit proposals to other members on any matters they wish to discuss at a meeting. Because of the importance of these rights, the act should require corporations to set out the process for admitting and terminating members. Corporations should also be obligated to maintain an up-to-date list of members.

Corporations should be encouraged to limit membership to those who take positive steps to indicate their intention to participate in the governance of their organizations. Although non-profit corporations should remain free to create classes of members that do not carry voting rights as a way to affiliate participants, patrons, volunteers or donors, ALRI recommends that the members of those classes have no entitlement under the new act. Corporations that wish to confer rights on non-voting members with respect to specific matters affecting their classes of members should so provide in their articles or by-laws.

Financial Accountability and Transparency

An accountable non-profit sector is important. However, we think that the responsibility to hold corporations accountable for the stewardship of monies received and the safety or quality of services provided should rest with the members. Corporations should be required to place annual financial statements before the members at the annual general meeting, and subsequently allow the members meaningful access to books and records upon request.

To reduce compliance costs, ALRI also recommends removing provisions requiring corporations to file audited financial statements with the corporate authorities as part of their annual report. Because financial statements would no longer be accessible through a corporate registry search, third parties requiring copies of these statements will have to request them directly from the corporations (e.g. an organization receiving a grant may have to provide financial statements to the grantor as a condition of receiving the grant).

Similarly, we believe that corporations are generally in the best position to determine the appropriate level of formality for the review of their financial statements, that is, internal audit, review engagement or external audit. ALRI recommends leaving corporations free to set out financial review requirements in their by-laws in accordance with the wishes of their

members, grantors or other stakeholders. The act should, however, include a default provision requiring the conduct of a review engagement where the by-laws are silent.

Fundamental Changes

During their existence, corporations may go through a number of fundamental changes, including amalgamation and merger of corporations, continuance into other jurisdictions, or sale of or disposition of substantially all corporate assets. These changes can significantly affect the rights of members and other stakeholders. ALRI recommends the inclusion of procedures designed both to facilitate these fundamental changes and to ensure the protection of those involved.

Additionally, corporations may sometimes have to wind up their operations. The new act should include provisions with respect to the voluntary liquidation and dissolution, administrative dissolution and judicial dissolution of non-profit corporations. ALRI recommends that corporations that elect to incorporate as fully restricted corporations under the act be required to distribute their net assets to other fully restricted corporations, registered charities or qualified donees within the meaning of the *Income Tax Act*. Corporations that choose to incorporate as partly restricted corporations should retain the ability to distribute any remaining property to their members on dissolution.

Registration of Extra-provincial Corporations

Corporations that are incorporated in another jurisdiction but carry on business in Alberta must be registered in the province. Although the registration requirement applies to all for-profit and non-profit corporations, the data indicates that only a small number of extra-provincial non-profit corporations are currently registered. The reason may be that corporations incorporated under non-profit legislation in another jurisdiction may not be aware that they must register in Alberta as this requirement is found only in our Business Corporations Act. To bring some clarity, ALRI recommends that the registration requirement for extra-provincial corporations be included in the non-profit legislation too.

Corporate Remedies

Disputes within organizations can be very time consuming and costly. In some cases, consequences are so serious that organizations are no longer able to fulfill the purposes for which they were created. There is a strong need to provide better procedures for members to hold corporations to account and more guidance about how to deal with internal disputes. The new act should give preference to internal remedies over external remedies and collective remedies over individual remedies.

Corporations should be encouraged to establish their own procedures for settling disputes, dissension or controversies among their directors, officers, members or volunteers. ALRI also recommends the inclusion of internal remedies aimed at eliminating the need for court intervention, including a right for members to requisition a meeting to resolve matters arising out of the operations of the corporation, or to be paid back the value of their membership when some important changes from which they dissent are undertaken.

Where these internal remedies fail to resolve disputes, ALRI recommends there should be procedures by which directors, officers or members may apply to enforce rights arising under the act, regulations, articles or by-laws, including an application for a compliance or restraining order, or for leave to bring a derivative action in the name or on behalf of the corporation. However, we think that remedies designed to give courts the jurisdiction to redress direct financial losses suffered by individual stakeholders, such as an oppression remedy or application for court-ordered liquidation and dissolution, have no real relevance outside the for-profit context.

Transitional Issues

Existing corporations will need to take positive steps to continue under the new act and check that their governing documents comply with any new requirements. Because of the flexibility of the proposed regime, we believe that many corporations will have little to do to be in compliance. Nonetheless, we recognize that the transition process can be lengthy and require an adequate transition period. ALRI recommends that period to be no less than three years. The corporate authorities should have the power to dissolve a corporation that has failed to make the transition into the new act within the transition period, but dissolution should not be automatic.

To facilitate the transition process, ALRI recommends that there be model by-laws available for corporations that do not have ready access to legal advisers. Model by-laws will provide a simple, cost-effective way to incorporate or continue under the new act. However, corporations should be encouraged to put time and effort into drafting by-laws that better reflect their own needs and circumstances. The Report for Discussion identifies a number of areas that should be given serious thought.

Issues and Recommendations

Table of Abbreviations

LEGISLATION

BCA	*Business Corporations Act*, RSA 2000, c B-9
CNCA	*Canada Not-for-profit Corporations Act*, SC 2009, c 23
Companies Act	*Companies Act*, RSA 2000, c C-21
ONCA	*Not-for-Profit Corporations Act, 2010*, SO 2010, c 15
Saskatchewan Act	*Non-profit Corporations Act, 1995*, SS 1995, c N-4.2
Societies Act	*Societies Act*, RSA 2000, c S-14

LAW REFORM PUBLICATIONS

ALRI Report 49	Institute of Law Research and Reform, *Proposals for a New Alberta Incorporated Associations Act*, Final Report No 49 (1987), online: <www.alri.ualberta.ca/docs/fr049.pdf>
BCLI Consultation	British Columbia Law Institute, *Proposals for a New Society Act*, Consultation Paper (August 2007), online: <www.bcli.org/sites/default/files/Society_Act_Consultation_Paper_0.pdf>
BCLI Report	British Columbia Law Institute, *Report on Proposals for a New Society Act*, BCLI Report No 51 (July 2008), online: <www.bcli.org/sites/default/files/BCLI_Report_on_Proposals_for_a_New_Society_Act.pdf>
Saskatchewan Report	The Law Reform Commission of Saskatchewan, *Liability of Directors and Officers of Not-for-Profit Organizations*, (July 2008), online: <www.lawreformcommission.sk.ca/directorsfinal.htm>

CHAPTER 1

Principles and Approach

A. Introduction

[1] Alberta's non-profit sector makes a significant contribution to the economic and social well-being of Albertans. As of March 2014, there were 24,591 active, provincially incorporated non-profit corporations in Alberta.[1] Across the province, these organizations generate revenues of over $9.6 billion each year, employ over 175,000 people and have more than 2.5 million volunteers.[2]

[2] The non-profit sector in Alberta is also extremely diverse.[3] It operates in areas ranging from sports and recreation, the arts, religion, post-secondary education to healthcare. Non-profit corporations range from those with more than $1 million in revenue and a staff of paid employees, to those with very limited revenue sources, who are entirely dependent on volunteers for program delivery.

[3] Non-profit organizations may choose from one of three basic legal forms, including an unincorporated association, charitable trust or incorporation. Incorporation, however, is generally the preferred form and is therefore the focus of this project.[4] The two principal statutes for incorporating a non-profit organization provincially are the *Societies Act* and the *Companies Act*.[5]

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[1] Figures provided by the Government of Alberta. There are 18,697 active non-profit corporations under the *Societies Act*; 2,033 active non-profit corporations under Part 9 of the *Companies Act*; 3,067 active non-profit corporations under the *Religious Societies' Land Act*; and, 794 extra-provincial non-profits registered under the *Business Corporations Act*.

[2] Imagine Canada, *The Non-profit and Voluntary Sector in Alberta*: *Regional Highlights of the National Survey of Non-profit and Voluntary Organizations,* at vii, available online at: <www.imaginecanada.ca/files/www/en/nsnvo/f_alberta_sector_report.pdf>.

[3] Imagine Canada, at vii. See also Calgary Chamber of Voluntary Organizations (CCVO), *2014 Alberta Nonprofit Survey*, available online at: <www.calgarycvo.org/wp-content/uploads/2014/05/2014-Alberta-Nonprofit-Survey-Web.pdf>.

[4] The advantages of incorporation include: (1) limited liability; (2) greater permanency; (3) a defined basic structure and governing rules; (4) external organizations, businesses and lending institutions may be more comfortable dealing with an incorporated body; (5) some funding agencies may insist on this form before any grants or financial assistance are provided; and (6) in most cases in order to qualify for registered charitable status, a non-profit must first be incorporated.

[5] *Societies Act*, RSA 2000, c S-14 [*Societies Act*] and *Companies Act*, RSA 2000, c C-21 [*Companies Act*]. Some organizations are incorporated under other statutes, such as the *Religious Societies' Land Act*, RSA 2000, c R-15. Although outside the immediate scope of this project, the issue of how changes to Alberta non-profit corporate legislation may affect organizations incorporated under the *Religious Societies' Land Act* is briefly discussed below.

Incorporation as a society under the *Societies Act* is the simplest and least costly way to incorporate. Some non-profit organizations incorporate under the *Companies Act*. The *Companies Act* contains more detailed and comprehensive provisions concerning the structure and operation of the organization.

[4] Given its importance, the sector needs to be supported by a governance framework that is clear and enabling. The current provincial corporate legislation does not do this well. Rather, it is characterized by gaps, inconsistencies and outdated concepts. The scope of ALRI's project is to reform the primary non-profit corporate legislation in Alberta, the *Societies Act* and Part 9 of the *Companies Act*. The challenge, however, is to develop a corporate legal framework that will meet the needs of this diverse sector.

1. PROCESS

[5] This is not the first time that reform of the non-profit corporate legislation has been proposed in Alberta. In 1987, ALRI recommended a new incorporated associations' act.[6] A bill based on these recommendations was introduced in the Legislative Assembly and given first reading. The government of Alberta then embarked on a province-wide consultation process based on these recommendations, but ultimately the reform initiative lacked the support of grassroots non-profit organizations needed to carry it forward.

[6] As will be discussed in subsequent sections, the context for the current reform project appears to be different from that of 1987. The importance of the non-profit sector continues to grow and other Canadian jurisdictions have recently introduced legislative reforms. However, in order to better understand the sector, recommend legislation tailored to the needs of the non-profit organizations, and ensure implementation of any proposed reforms, it is crucial to effectively engage grassroots organizations in every step of the reform process.

2. NEED FOR REFORM

[7] As we mentioned at the outset, in our view, the *Societies Act* and the *Companies Act* do not adequately support the non-profit sector and are in need of

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[6] Institute of Law Research and Reform, *Proposals for a New Alberta Incorporated Associations Act*, Final Report No 49 (1987), available online: <www.alri.ualberta.ca/docs/fr049.pdf>, [ALRI Report 49].

reform. In ALRI Report 49, we summarized the importance of the legislative machinery for non-profit corporations as follows:[7]

> The incorporation of a corporate entity provides an organizational structure for an activity; it defines the relationships and balances the interest of majorities, minorities and managers; it helps an organization to obtain charitable or tax-exempt status; and it protects its members against claims for things done by the corporate entity.

[8] The starting point of this Report is to find ways to allow non-profit corporations to fulfill their mission while having appropriate safeguards in place to protect the interests of various stakeholders. We think that these safeguards should only increase when risks increase. Such an approach allows for more flexibility in the operation of the legislative framework. This additional leeway may in turn provide an answer to the challenge posed by the diversity of the non-profit sector.

[9] A brief review of the history of the *Societies Act* and Part 9 of the *Companies Act* is helpful in better understanding the shortcomings of the current legislation. Both statutes date back to the 1920s and are based on UK laws. Whereas the *Societies Act* originated with the legal framework for benevolent or charitable organizations, Part 9 of the *Companies Act* was an add-on to the companies' legislation aimed primarily at the for-profit sector.

a. *Societies Act*

[10] The current *Societies Act* has remained relatively unchanged since it was first introduced in Alberta in 1924. Like the 1924 Act, the current legislation provides for the incorporation of societies for "any benevolent, philanthropic, charitable, providence, scientific, artistic, literary, social, educational, agricultural, sporting or other useful purpose, but not for the purpose of carrying on any trade or business."[8] The corporate authorities continue to take an active role and can refuse an application for incorporation.[9] It leaves many of the key governance issues to be determined by the by-laws of an individual organization. While this approach provides for greater flexibility, it also leads to difficulties when societies, lacking in legal sophistication, must draft by-laws.

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[7] ALRI Report 49, at 5-6.

[8] *Societies Act,* s 3(1).

[9] *Societies Act*, s 10.

Most of the recent cases concerning the *Societies Act* involve interpretation questions or errors in the drafting of society by-laws.[10]

b. *Companies Act*

[11] Part 9 of the *Companies Act* can be traced back to Ordinance No. 3 of 1886, the first territorial ordinance to deal with the incorporation and operation of companies. It was replaced in 1913 with the *Companies Act.* The present form of the *Companies Act* closely resembles the 1929 version of the Act. The Act provides a more limited role for government supervision in that incorporation is as of right.[11] Unlike the *Societies Act*, a non-profit incorporated under the *Companies Act* can engage in business activities provided the proceeds are used to promote its objects.[12] In 1981, the Alberta government determined the *Companies Act* was obsolete and enacted the *Business Corporations Act*.[13] The *Companies Act* stopped applying to for-profit corporations on February 1, 1982.[14] The *Companies Act*, however, continues to apply to non-profit corporations.

3. REFORM IN OTHER CANADIAN JURISDICTIONS

[12] The reform trend in Canada, both provincially and federally, is to introduce new non-profit legislation that is better harmonized with the business corporation legislation in their respective jurisdictions. These new statutes adopt an approach to non-profit governance that is more in line with that of for-profit corporations. While this approach has merits, it may not be suited for the Alberta non-profit sector. It is therefore important to look at the different options and what it would mean for the sector in order to put forward the best model for Albertans.

[13] Previously, Saskatchewan stood out as the only province with modern non-profit legislation. Its *Non-profit Corporations Act* entered into force in 1995 and has operated with few problems since then.[15] More recently, new non-profit

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[10] See for example, *Penton v Métis Nation of Alberta Assn* (1995), 171 AR 140 (QB); *Orr v Alook*, 2000 ABQB 477; *Boucher v Métis Nation of Alberta Assn,* 2008 ABQB 262; *Kim v Kim*, 2009 ABQB 608.

[11] *Companies Act*, s 15(1).

[12] *Companies Act*, ss 200(1) and 202(1).

[13] *Business Corporations Act*, RSA 2000, c B-9 [BCA].

[14] *Business Corporations Act*, SA 1981, c B-15, s 284(5).

[15] *Non-profit Corporations Act, 1995,* SS 1995, c N-4.2 [Saskatchewan Act].

legislation was introduced by the federal government, the government of Ontario and is being considered by the government of British Columbia.[16]

[14] The new federal act, the *Canada Not-for-profit Corporations Act*, provides for the phased in repeal of Part II of the *Canada Corporations Act*.[17] The Act provides a modern corporate governance framework for the regulation of federally incorporated non-profit corporations.[18] It is based primarily on provisions of the *Canada Business Corporations Act* and some provincial non-profit legislation.[19]

[15] Ontario also passed new non-profit corporate legislation, the *Not-for-Profit Corporations Act*, in 2010.[20] Passage of the ONCA was motivated by the outdated nature of the *Corporations Act* which had been enacted in 1907 and last significantly revised in 1953, and by the desire to harmonize the Ontario law with the new federal statute.[21] The new legislation received Royal Assent in December 2010, but has not yet entered into force pending Proclamation. There are reportedly a number of significant administrative issues to be resolved before Proclamation.[22] Bill 85, which included technical amendments necessary to implement the ONCA, was introduced in 2013 but died when the 2014 provincial election was called.[23] The ONCA is not expected to come into force before 2016.

[16] In 2008, the British Columbia Law Institute recommended changes to better harmonize British Columbia's *Society Act* with its *Business Corporations Act*.[24] The year after, the Ministry of Finance commenced a review of the *Society Act* with a letter to stakeholders seeking general input on issues under the current legislation. This was followed by a 2011 Discussion Paper inviting public

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[16] British Columbia (Ministry of Finance), *Societies Act White Paper: Draft Legislation with Annotations*, August 2014, available online: <www.fin.gov.bc.ca/pld/fcsp/pdfs/SocietyActWhitePaper.pdf> [*Societies Act White Paper – August 2014*].

[17] *Canada Not-for-profit Corporations Act*, SC 2009, c 23 [CNCA]; *Canada Corporations Act*, RSC 1970, c C-32 [CCA].

[18] Wayne D. Gray, "A Practitioners Guide to the New Canada Not-for-profit Corporations Act" (2010) 89 Can Bar Rev at 153.

[19] *Canada Business Corporations Act*, RSC 1985, c C-44.

[20] *Not-for-Profit Corporations Act, 2010*, SO 2010, c 15 (not yet in force) [ONCA].

[21] *Corporations Act*, RSO 1990, c C.38.

[22] Ontario Nonprofit Network, February 8, 2013 reports that a significant amount of time will be required to work out administrative issues before proclamation and to monitor afterwards.

[23] Bill 85, *An Act to Amend Various Companies Statues and to amend Other Statutes Consequential to the Not-For-Profit Corporations Act, 2012*, 2nd Sess, 40th Leg, Ontario, 2013.

[24] *Society Act*, RSBC 1996, c 433; *Business Corporations Act*, SBC 2002, c 57. British Columbia Law Institute, *Report on Proposals for a New Society Act*, BCLI Report No 51 (July 2008) [BCLI Report]. See also British Columbia Law Institute, *Supplementary Report on Proposals for a New Society Act*, BCLI Report No 63 (April 2012).

comment on specific proposals for reform.[25] In August 2014, the Ministry released the *Societies Act White Paper: Draft Legislation with Annotations* and launched another round of public consultations.[26]

[17] While harmonization between sectors and between jurisdictions provides benefits, it is not an end in itself. ALRI's Report takes a different approach. It does not start by proposing harmonization with the business corporations' legislation in Alberta. Rather, it starts by focusing on what non-profit corporations are, what they do, and what they need to do to carry out their particular purposes in an efficient and effective manner. Having these concerns front and center will help to tailor a clear and enabling legal framework.

B. Guiding Principles and Values

[18] The term "for-profit" affirmatively describes the general goal of this type of corporation – that is, maximizing shareholder profit. In contrast, the term "non-profit" does not offer an affirmative description of what a non-profit corporation is. It merely indicates the absence of a profit motive for this type of corporation. Non-profit corporate law has developed in much the same way. Rather than a series of affirmative provisions, it is typically characterized by provisions that limit or eliminate the means for an organization to distribute surpluses or accretions.

[19] This Report takes a more affirmative approach which neither implies adopting nor rejecting long-standing principles of non-profit corporate law. It simply suggests that non-profit corporations' powers and duties – and any limitations or restrictions on these powers and duties – should be based on, and meaningfully advance, the desired guiding principles and values. In our view, there are at least four: (1) strengthening the non-profit identity, (2) enhancing sustainability, (3) providing good governance standards and safeguards, and (4) accommodating differences within the sector.

1. STRENGTHENING THE NON-PROFIT IDENTITY

[20] "Identity" refers to the set of characteristics by which a person, group or thing is recognized or known. An organization's identity or brand is an

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[25] British Columbia, Ministry of Finance, *Society Act Review Discussion Paper*, December 2011.

[26] *Societies Act White Paper – August 2014*, note 16.

intangible asset that encapsulates who it is, where it is going, what it does and why that matters.[27] Internally, identity creates organizational cohesion and effectiveness by keeping a clear focus on its mission. Externally, it reflects the image that stakeholders have of an organization, and serves as a fundraising and networking tool.

[21] Of course, there are many forces involved in building an organization's identity, but there are ways to strengthen this identity through non-profit corporate legislation. For example, defining or requiring an organization to state their purpose may be part of it. A defined purpose may help a non-profit to use its resources more efficiently and ultimately, increase its ability to meet the needs of its members or the community. Another way to strengthen the non-profit identity may be to eliminate the forces that can distract organizations from their non-profit purpose. Prohibiting non-profit corporations from issuing share capital or distributing assets to their directors or members may distinguish non-profit organizations from the for-profit sector. These prohibitions may also be important in that they may mean fewer resources will be diverted from operations.

2. ENHANCING SUSTAINABILITY

[22] One of the biggest challenges facing the non-profit sector is sustainability. There are many facets to sustainability. First, and most importantly, sustainability encompasses economic sustainability, that is, the ability to secure continuous, diverse funding and to use those funds efficiently and effectively to further the purpose of the organization. Enabling non-profit corporations to access various sources of funding, such as public grants, donations, member dues, and also commercial revenue, contributes to their financial viability and independence. Second, a stable board and the ability to attract and retain board members can enhance sustainability. Third, sustainability encompasses the ability to stay relevant, that is, the flexibility to continue to meet the changing needs of members of the public.

[23] The use of the qualifier "enhancing" before sustainability acknowledges that a legislative framework should not be overly rigid or prescriptive. Rather, it should permit a non-profit corporation to choose from a range of options and

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[27] Nathalie Kylander and Christopher Stone, "The Role of Brand in the Nonprofit Sector", *Stanford Social Innovation Review* 10:2 (Spring 2012), available online at: <www.ssireview.org/articles/entry/the_role_of_brand_in_the_nonprofit_sector>.

decide for itself what best suits its particular circumstances. For example, the legislation might permit a non-profit corporation to pursue a particular revenue-generating option. However, it would be up to the corporation to carefully consider what resources would be required to carry out this option and what other benefits might not be available as a result of this choice.[28]

3. GOOD GOVERNANCE AND SAFEGUARDS

[24] In order to effectively carry out their purpose, non-profit corporations also need tools to define strategies, manage resources, verify performance and readjust matters when needed. Effectiveness, efficiency, responsiveness, participation, transparency and accountability are central pillars of – and sometimes preconditions for – good governance. At the outset, the role of a legal framework is to facilitate those processes and to delineate the obligations and rights of everyone involved. Organizations can then build on baseline good governance standards to meet their particular needs.

[25] Safeguards should only be required as a last resort to redress and remedy those situations where good governance fails. Imperative provisions should be reduced to a minimum and should serve clear and meaningful objectives. The compliance burden may be significant and may strain resources and have an adverse effect on organizations' sustainability.[29] Further, good governance standards that are appropriate for some non-profit corporations may not be appropriate for all classes of non-profit organizations.

4. RECOGNIZING DIFFERENCES WITHIN THE NON-PROFIT SECTOR

[26] A wide range of non-profit organizations may incorporate. Generally, they can be classified into four themes:

- charitable organizations which include poverty assistance, educational, spiritual and other community benefit groups,

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[28] For instance, engaging in commercial activities requires a significant investment of time and money, and may unduly reduce the amount of resources available for the members or the public, without any assurance that this will result in any surpluses or accretions. Having the capacity to offer investor returns is not a guarantee that it will be able to draw enough investments to compensate for the share of gains and capital that goes back to investors, and the loss of financial benefits available exclusively to "non-distribution-constraint" organizations (e.g., tax exemption, casino licence).

[29] For example, robust external audit requirements may ensure good governance. However, they may divert much needed funds from operations and consequently affect the sustainability of an organization.

- social and recreational organizations which include hobby, garden, sport and country clubs,
- membership organizations which include fraternal, professional and business associations, and
- advocacy organizations which include groups that champion a particular interest or position and attempt to influence the public opinion, decision-making process, political and/or legislative action.

Even within these broad classifications, there can be differences based on source of funds, revenues generated, size of the organization, etc.

[27] While non-profit corporations may share some common traits, what they do and what they need to carry out their particular purpose largely vary. Consequently, the relative importance of the principles and values identified may differ from one type of organization to another.[30] For example, strengthening the non-profit identity may be more important for a charitable organization such as the United Way than it is for an advocacy organization such as the Alberta Liquor Store Owners Association. To the extent that it is possible to identify functional differences between non-profit corporations, these should be recognized and accommodated in the incorporation legislation.

C. Legislative Approach

ISSUE 1

What legislative approach should be taken with non-profit corporate legislation? (Recommendations 1 to 4)

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[30] For instance, as Nelligan and Burke note: "For the purpose of analysis, it is useful to separate corporations that currently have minimal governance structure dedicated to members from those that are highly structured in respect of members. While it is not possible to strictly delineate the two types of organizations, examples of corporations which are not structured to give members significant participation in governance include cultural institutions such as museums, art galleries, and sports or recreational organizations that sell memberships principally as a fundraising tool or as an entitlement to participate in a sport or activity, while examples of member-focused corporations would include professional or trade associations formed specifically to represent the interests of, educate and/or facilitate interaction among their members". See Margaret Nelligan and Jeremy Burke, "Governance and Member Rights Under New Not-For-Profit Legislation", *Canadian Society of Association Executives*, available online at: <www.csae.com/Resources/ArticlesTools/View/ArticleId/1488/Governance-and-Member-Rights-Under-New-Not-For-Profit-Legislation>. See also Don Bourgeois, "Three Views on Bill C-21: Canada Not-For-Profit Corporations Act", *The Philanthropist*, 21:1 (2007), available online at: <www.thephilanthropist.ca/index.php/phil/article/download/18/18>.

[28] It has been suggested that the defining characteristics of non-profit organizations are as follows:[31]

- they should be established for a public purpose or for the non-financial benefit of their members,
- they should be private and independent,
- they should be self-governing, and
- in general, their income should not be distributed to members, directors or officers, except as reasonable compensation for services rendered.

[29] With the defining characteristics of non-profit organizations in mind, the question that follows is: what impact should these differences have in determining the appropriate regulatory framework? Are the differences with the for-profit sector significant enough to warrant legislation that is separate and distinct from that of the for-profit sector?

1. REGULATORY MANDATE

[30] The government's role in the non-profit sector has been described as having four key elements.[32] The first is a facilitative role: the government should do what it can to facilitate non-profit activity. The second is a helping role: the government should do what it can to provide funding, infrastructure and to enhance the sector's credibility. The third is a protective role: the government should introduce measures to protect the sector from fraudulent or deceptive activities. The fourth is a policing role: the government should police its own expenditures in the sector to ensure that they remain properly targeted and effective. The criticism that has been levelled at past Canadian non-profit legislation is that it tended to underemphasize the government's facilitative, helping and policing role and overemphasize its protective role.[33]

[31] With respect to this current reform effort, how do we find an appropriate balance among these four key elements? What issues need to be included in a

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[31] Law Commission of New Zealand, *Reforming the Incorporated Societies Act 1908,* Issues Paper 24 (June 2011) at 5.

[32] David Stevens, "Framing an Appropriate Corporate Law" in Jim Phillips, Bruce Chapman and David Stevens, eds, *Between State and Market: Essays on Charities Law and Policy in Canada* (Montreal and Kingston, McGill-Queen's University Press, 2001) 547, at 549.

[33] Stevens at 549.

clear formulation of the basic legal framework for the sector? What issues could be left to non-profit corporations to work out for themselves? Should this legal framework provide mandatory or default rules?[34] The challenge is to put in place legislation that strikes an appropriate balance while bearing in mind that non-profit corporations have diverse governance needs and capabilities to comply with regulatory requirements.

[32] ALRI's Report identifies only a few areas where the new act should be prescriptive. Because mandatory provisions are enforceable even if the corporations attempt to modify them through their articles of incorporation or by-laws, they provide a way to protect the interests of stakeholders in certain circumstances. In most cases, however, we think that the act should set out default provisions which apply when the corporation's governing documents are silent. Corporations should have the option of overriding these provisions, if they so choose, by providing alternate rules to the default ones.

[33] The new act should be simple enough to provide an organizational framework that would be appropriate for smaller, less-sophisticated non-profit organizations. Larger or more sophisticated organizations should be able to supplement or opt out of the framework, if they so choose, through their governing documents.

RECOMMENDATION 1

Mandatory legislative provisions should be kept to a minimum. Any mandatory provisions should be clearly identified in the new act. Default provisions should be preferred to allow maximum flexibility within the basic legal framework.

[34] It is also important to be mindful of the limited scope of this project. This Report addresses the different aspects of the creation and governance of a non-profit corporation. Other issues relating to that entity such as fundraising activities, use of public monies or tax status are dealt with in other statutes which are outside the scope of our project. While we cannot ignore these issues, it is important to keep them separate in the Report. The aim of non-profit corporate legislation is to provide an organizational framework for non-profit

[34] Mandatory rules mean that corporations must comply with those rules and also that the legislation supersedes any inconsistent rules in the by-laws. Default rules, on the other hand, only apply when the articles or by-laws are silent; the corporation always has the option to override default rules if they do not meet its own circumstances.

organizations. We do not think that the new legislation should go beyond this objective.

RECOMMENDATION 2

Non-profit corporate legislation should focus on providing a vehicle for incorporating a non-profit organization. Accordingly, the new act should not attempt to address fundraising or tax issues by setting out differential requirements based on how much non-profit corporations receive in income from public sources or on whether or not they intend to be tax exempt. However, it may be useful to provide some guidance or educational materials outside the act.

[35] This Report discusses the adoption of a single piece of legislation that would repeal and replace the *Societies Act* and the *Companies Act*. This legislation should not only accommodate the swift incorporation of new non-profit organizations, but also a smooth transition process for societies incorporated under the *Societies Act* and companies incorporated under Part 9 of the *Companies Act*. Transitional issues are examined in the last section of the report.

[36] The Report does not address the issue of whether or not the *Religious Societies' Land Act* incorporation mechanism, which is used for purposes of holding land under the land titles system, allows a congregation incorporated under Part 2 of that Act to carry on activities other than holding land.[35] What is certain, however, is that the *Religious Societies' Land Act* is deficient with respect to basic corporate governance tools and remedies. Therefore, we think that a congregation should have the option to incorporate under the new act as an alternative to incorporation under the *Religious Societies' Land Act*. To this end, the proposed legislation should be set up so that a congregation currently incorporated under the *Religious Societies' Land Act* may find benefit from continuing under the new act and, thereby, remove any doubt about the range of activities that it can carry out.

RECOMMENDATION 3

The *Companies Act* and the *Societies Act* should be repealed and replaced by new non-profit corporate legislation. Non-profit corporations that are currently incorporated under either the *Companies Act* or the *Societies Act* should continue under the new act. Congregations currently incorporated under Part 2 of the

[35] *Religious Societies' Land Act*, RSA 2000, c R-15, s 12.

Religious Societies' Land Act should have the option to continue under the new act.

2. CLASSIFICATION SCHEME OR BASELINE LEGISLATION?

[37] One way legislation has tried to accommodate diversity within the non-profit sector is by having different legislative provisions apply to different categories of non-profit corporations. From a legislative perspective, this raises the practical question as to whether legislative reform in this area should incorporate a classification scheme or alternatively, set out minimum standards common to all.

[38] The principal advantage of a classification scheme is that the needs of different types of non-profit corporations could be more easily met. The disadvantage is that it could be overly cumbersome or difficult to classify non-profit corporations. [36] The result could be that organizations are wrongly classified or do not fit well within the defined categories.[37] In contrast, common minimum standards can accommodate a variety of different kinds of non-profit corporations, but may not be sufficiently detailed for all non-profit corporations.

[39] If a classification scheme were adopted, there are several possible bases for classification including the size of the organization, the source and level of funding, and whether the organization is primarily intended to benefit its membership or the public.[38] The challenge with all of these possible bases is defining the classification so that it is neither overly broad nor overly complicated to apply. Others have suggested that a classification scheme should be based on a non-profit corporation's capacity to comply with the legislation, but this would seem somewhat circular.

[40] Regardless of the basis of classification, the areas of possible differentiation include:[39]

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[36] Industry Canada, Corporate and Insolvency Law Policy Directorate Policy Sector, *Reform of the Canada Corporations Act: Discussion Issues for a New Not-for-Profit Corporations Act*, March 2002 at 5, available online: <www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/optionfinal_en_ed.pdf/$FILE/optionfinal_en_ed.pdf>.

[37] It was also noted that classification scheme might result in some confusion with the Canada Revenue Agency's rules regarding the designation of charitable status for tax purposes.

[38] The Ontario Law Reform Commission recommended a rather complicated classification scheme which divided non-profit corporations into the following five categories: religious, political, charities, mutual benefit and general. "The Nonprofit Corporation: Current Law and Proposals for Reform," in Report on the Law of Charities, vol 2 (Toronto: The Commission, 1996) 451–506, at 460, 465-466.

[39] Ontario Ministry of Services, Policy and Consumer Protection Services Division, *Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations*, Consultation Paper (May 7, 2007) at 19.

- distribution of assets upon liquidation,
- transferability and repurchase of membership,
- the rights and responsibilities of the membership,
- member rights on fundamental changes,
- prohibitions or restrictions on amalgamations,
- fiduciary obligations of directors and officers, and
- audit requirements.

[41] We do not think that the act should include a formal classification scheme. The focus of this Report is to propose rules common to all non-profit corporations whenever possible. However, we recognize that a one-size governance model does not always fit all. Accommodating different types of non-profit corporations may require us to leave options open in certain areas. Therefore, the Report discusses the possibility to organize the new legislation into self-assessed categories of corporations with their particular rules.[40]

[42] As mentioned above, it is also important to bear in mind that the aim of the proposed baseline legislation is to provide for default rules where the corporations' governing documents are silent. This allows corporations to tailor rules to fit their particular characteristics if needed.

RECOMMENDATION 4

The new act should be a single piece of baseline legislation with different parts, where necessary, to accommodate different types of non-profit corporations.

[40] This issue is discussed in the *Asset Distribution* section below.

CHAPTER 2

Incorporation and Capacity

A. Incorporation Process

ISSUE 2

Should incorporation be as of right? Should it be subject to the discretion of the corporate authorities? What should be essential components of the incorporation process? (Recommendations 5 to 9)

[43] When the concept was first introduced, bodies corporate were only created at the discretion of the Minister. Incorporation could be rejected for any reason the corporate authorities considered sufficient. This system was replaced with incorporation as of right for business corporations when the new business corporation legislation was adopted. In recent years, there have been calls to abandon the discretionary system in favor of the simpler and faster incorporation as of right for non-profit corporations as well.

[44] The review and approval process offers a mechanism for some external control and may act as a shortcut in the decision making of potential funders, donors, volunteers, members, partners, lenders, investors or clients. This process has nevertheless a number of drawbacks. First and foremost, it initially requires a significant expenditure of time and resources from both applicants and corporate authorities, and can subsequently deter non-profit corporations from renewing their governing documents to keep them current and relevant.

[45] On balance, we therefore think that incorporation of a non-profit organization should be as of right. The legislation might specify what requirements an organization must meet to qualify for incorporation as of right, but would no longer involve review and approval by the corporate authorities. [41]

1. INCORPORATION REQUIREMENTS

[46] An application for a certificate of incorporation should include 3 separate forms: (1) articles of incorporation, (2) notice of directors, and (3) notice of

[41] Those legislative requirements should not involve any degree of discretion by the corporate authorities. For example, the act may require that articles of incorporation include a statement of purpose. The function of the corporate authorities would be to make sure the articles include such statement, not to review and approve the purpose of incorporation; they would have no discretionary power to reject that purpose.

registered office.[42] The application should also include a NUANS name search report and the filing fee.[43] By-laws would not have to be submitted with the application to obtain a certificate of incorporation. However, the new act should require that by-laws be filed within the prescribed period of time after the members have confirmed them.[44]

[47] Corporations are usually required to file a report or return every year. This annual report or return generally includes information such as the corporation's name and address, the date of the last annual meeting, any changes to the registered office or the directors, and, in some cases, the financial statements and report of a public accountant, if any.[45] We think that special attention should be given to ways of ensuring that public corporate records are up-to-date.[46]

RECOMMENDATION 5

Incorporation should be as of right under the new act, and only require the submission: (1) the articles of incorporation, (2) the notice of directors, (3) the notice of registered office, and (4) the NUANS name search report. Electronic filing should be encouraged.

2. GOVERNING DOCUMENTS

[48] There is a hierarchy of documentation in corporate governance:

- mandatory provisions, which are considered legislatively required and cannot be overridden by the articles or by-laws,
- articles of incorporation, which are considered fundamental and can only be changed by special resolution, and

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[42] Instead of having the notice of registered office in the articles of incorporation, it would be better to have it directly in a separate form to facilitate address changes. See *Societies Act*, s 24.

[43] NUANS is a computerized search system that compares a proposed corporate name with databases of existing corporate bodies to produce a list of existing names that are found to be the most similar to proposed name.

[44] For example, see CNCA, s 153 and *Canada Not-for-profit Corporations Regulations*, SOR/2011-223, s 60.

[45] See, for example, *Societies Act*, s 26. The issue of financial reporting is discussed in the *Financial Accountability and Transparency* section below.

[46] For instance, to make sure that any changes or amendments have been filed, there could be a "tick box" form which would have to be completed with the annual return as a reminder (e.g. Have you changed your registered office address? Have you changed your directors? Have you changed your by-laws?).

- by-laws, which are considered operational and can be changed by ordinary resolution.

[49] It may be easier to reference if the legislation is organized in the same "hierarchical order". Moreover, members should be aware of the provisions in the articles which may or may not also be in the by-laws. There needs to be a way to draw attention to the content of the articles to avoid disconnect between the articles and the by-laws. It has been suggested, for instance, that the content of articles be repeated into the by-laws, or that the articles be attached to the by-laws. However, having the articles repeated in or attached to the by-laws could be an onerous process. All in all, we think that education may be a better way to achieve awareness.

RECOMMENDATION 6

The new act should establish a clear hierarchy of documentation: the act should set out the mandatory rules; the articles of incorporation should establish the fundamental elements of the corporation; and the by-laws should regulate the affairs of the corporation.

a. Articles of incorporation

[50] The articles of incorporation are key documents which define the unique characteristics, structure and other primary rules governing the corporation. Any change to the articles is a fundamental change requiring member approval at some "increased" level (i.e. generally, articles can only be changed by special resolution of the members). Therefore, it is not necessary for the articles to include provisions that can be put in the by-laws. The provisions in the articles should be kept to a minimum because it is easier to change by-laws than it is to change the articles.

i. Name of corporation

[51] The articles should include the name of the corporation. The name usually needs to meet certain criteria.[47] The new legislation should contain similar

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[47] For example, the *Societies Act* provides that:

> **Name of society**
>
> **6(1)** Subject to the circumstances and conditions prescribed by the regulations, a society shall not have a name
>
> (a) that is prohibited by the regulations or contains a word or expression prohibited by the regulations,
>
> (b) that is identical to the name of
>
> *Continued*

requirements. As mentioned above, the application for incorporation should include a NUANS name search report.

ii. Statement of purpose

[52] As discussed below, we think that non-profit corporations should be required to include a statement of purpose in their articles.

iii. Number of directors

[53] The minimum and maximum number of directors should be provided in the articles. The specific number of directors and how to change that number within the range provided in the articles could be provided in the by-laws.

iv. Classes of membership

[54] The articles should set out the classes of members that the corporation is authorized to have. A corporation should have at least one class of membership with voting rights, unless provided otherwise in the articles. If the corporation is authorized to establish two or more classes of membership, any voting rights attaching to each of those classes or groups should be set out in the articles.

v. Restriction on distribution

[55] As discussed below, we think that the new legislation should be organized into a two-part model: (1) distribution restricted during existence and on dissolution (fully restricted), and (2) distribution restricted during existence but not on dissolution (partly restricted). Organizations should be required to indicate their election in the articles. Any other restrictions on the powers or activities of the corporation should also be included in the articles.

(i) a body corporate incorporated under the laws of Alberta, whether in existence or not,
(ii) an extra-provincial corporation registered in Alberta, or
(iii) a corporation incorporated by or under an Act of the Parliament of Canada,

(c) that is, in the opinion of the Registrar, similar to the name of
(i) a body corporate incorporated under the laws of Alberta,
(ii) an extra-provincial corporation registered in Alberta, or
(iii) a corporation incorporated by or under an Act of the Parliament of Canada
if the use of that name is confusing or misleading, or

(d) that does not meet the requirements prescribed by the regulations.

RECOMMENDATION 7

At a minimum, the articles of incorporation must include:

- the name of the corporation,
- a statement of purpose,
- a class of membership with voting rights,
- the minimum and maximum number of directors,
- an election respecting the distribution on dissolution, and
- any restrictions on the powers or activities of the corporation.

b. By-laws

[56] Once the corporation has been created, a number of other items must be considered. Among those are the corporation's by-laws, that is, operational or procedural rules that have to be kept relatively flexible. Incorporation statutes may include different types of by-law provisions, that is, mandatory, default or optional. The legislation sometimes specifies that a corporation's by-laws must at minimum address certain matters (mandatory by-law provisions).[48] It may also provide rules that apply only where the corporation's own by-laws are silent; these rules can generally be overridden (default by-laws provisions).[49] Finally,

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[48] In general, mandatory rules should be included in the articles not the by-laws. If the legislation contains any mandatory by-law provisions, there should be some sort of aide-memoire to make it easy to know what they are. See, for example, CNCA, s 154:

> **Conditions of membership**
>
> **154.(1)** The by-laws shall set out the conditions required for being a member of the corporation, including whether a corporation or other entity may be a member.
>
> **Classes of membership**
>
> **(2)** If the articles provide for two or more classes or groups of members, the by-laws shall provide
>
> (a) the conditions for membership in each class or group;
>
> (b) the manner of withdrawing from a class or group or transferring membership to another class or group and any conditions of transfer; and
>
> (c) the conditions on which membership in a class or group ends.

[49] Default rules will apply if there are no other provisions in a corporation's by-laws. If the default rules do not meet its needs or circumstances, a corporation may replace them by creating by-laws that will override these rules. Occasionally, however, default by-law provisions may set minimum standards (e.g. give a notice of meeting at least 10 days before the meeting). It is not always necessary for the legislation to provide default by-laws. However, there are situations where the lack (or inadequacy) of rules may hinder, if not paralyse, the operations of a corporation. As far as possible, default provisions should aim to cover those situations. The necessity of providing for specific default by-laws is discussed in the relevant sections. See, for example, CNCA, s 159(4):

> **Participation in meeting by electronic means**
>
> **159(4)** *Unless the by-laws otherwise provide*, any person entitled to attend a meeting of members may participate in the meeting, in accordance with the regulations, if any, by means

Continued

the legislation may indicate that a corporation has the ability to set out additional operational rules but leave it entirely up to the corporation whether or not to have these rules (optional by-laws provisions).[50]

RECOMMENDATION 8

The new act should contain provisions that operate as default by-laws in the absence of any other provisions in a corporation's by-laws.

[57] As mentioned above, by-laws do not have to be included in the application to obtain a certificate of incorporation (or continuance).[51] In general, directors will make by-laws at the first organizational meeting. This process can be simplified by referring to model by-laws, which are usually drafted to apply to a typical non-profit corporation, whenever model by-laws are available. [52] Model by-laws can be "customized" to suit the particular characteristics and circumstances of a corporation.[53] The by-laws will then be submitted for approval at the next meeting of the members.[54]

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of a telephonic, an electronic or other communication facility that permits all participants to communicate adequately with each other during the meeting, if the corporation makes available such a communication facility [emphasis added]. A person so participating in a meeting is deemed for the purposes of this Act to be present at the meeting.

[50] There may be rules that a corporation wishes to have that are not addressed by the default rules. See, for example, CNCA, s 137:

> **Decisions made by consensus**
>
> **137.(1)** The by-laws may provide that the directors or members shall make any decision by consensus, including a decision required to be made by a vote, except a decision taken
>
> (a) by a resolution referred to in subsection 182(1);
>
> (b) by special resolution; or
>
> (c) by a vote if consensus cannot be reached.
>
> **Meaning of consensus, etc.**
>
> **(2)** By-laws that provide for consensus decision-making shall define the meaning of consensus, provide for how to determine when consensus cannot be reached and establish the manner of referring any matter on which consensus cannot be reached to a vote.
>
> Voting requirements satisfied
>
> **(3)** A decision made by consensus in accordance with this section is deemed to satisfy any requirement under this Act for the taking of a vote.

[51] Transitional by-laws issues are discussed in the last section of this Report.

[52] "Model by-laws" refers to a set of off-the-rack rules that can be readily used by corporations that choose not to develop their own by-laws. Mandatory, default and optional by-law provisions are built into the legislation, whereas model by-laws are generally presented as a stand-alone document outside the legislation.

[53] For example, Corporations Canada proposes a set of model by-laws for non-profit corporations incorporated under the CNCA, available online at: <www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs04999.html>.

[54] For example, the CNCA provides that:

> **By-laws**
>
> *Continued*

[58] By-laws can be changed by simple majority, unless otherwise provided by the statute or the governing documents. For example, the CNCA provides that a special resolution of members is needed to make, amend or repeal by-law provisions dealing with conditions of membership, notice of meetings to members, transferability of membership, or absentee voting. Directors cannot make, amend or repeal by-law provisions for which a special resolution of members is required.[55]

[59] By-laws or amendments to by-laws should not have to be submitted for review and approval by the corporate authorities; they should simply be deposited with the public repository. By-laws should be available and kept on file by the corporate authorities as it is important to have corporate documents in some central registry. In addition, member rights to access by-laws, especially the right to access by-laws in the interim period before they are filed, should be increased if there is no longer supervision by the corporate authorities.[56]

[60] Although stating that the by-laws are "of no force and effect" until they are filed may increase certainty, it may also cause difficulties. Therefore, we think that it would be more practical to provide that the by-laws are in effect when approved by the members. The act should however require that by-laws or amendments be filed within the prescribed period of time after their approval by the members, or before the next annual general meeting, whatever date comes first.[57]

RECOMMENDATION 9

By-laws should take effect when approved by the members, unless otherwise provided by the act or governing documents. The new act should require corporations to file by-laws with the corporate authorities within the period prescribed in the act or the regulations.

152.(1) Unless the articles, the by-laws or a unanimous member agreement otherwise provides, the directors may, by resolution, make, amend or repeal any by-laws that regulate the activities or affairs of the corporation, except in respect of matters referred to in subsection 197(1).

Member approval

(2) The directors shall submit the by-law, amendment or repeal to the members at the next meeting of members, and the members may, by ordinary resolution, confirm, reject or amend the by-law, amendment or repeal.

[55] See CNCA, ss 152(1) and 197(1).

[56] This issue is discussed in the *Members' Roles and Rights* section below.

[57] The new act could also require that the by-laws or any amendments be filed before the annual return can be accepted. For instance, the annual return form could require corporations to indicate whether by-laws were made, amended or repealed, and, if so, whether the by-laws or changes to by-laws have been filed with the Corporate Registry. See note 46 above.

B. Capacity

[61] Broadly defined, "corporate capacity" refers to what a corporation is empowered to do. There are three different ways to circumscribe corporate capacity: (1) restrict the purposes of incorporation, (2) restrict the activities of the corporation, and (3) restrict the exercise of powers. Such restrictions should be justified, meaningful and enforceable as they define management duties and membership rights. But all these pieces also need to work together, whether by complementing or supplementing each other. Therefore, an understanding of the broad picture is essential for setting out a coherent and enabling legal framework for non-profit corporations.

1. DOCTRINE OF *ULTRA VIRES*

ISSUE 3

Should the doctrines of *ultra vires* and constructive notice be abolished? (Recommendation 10)

[62] Unlike a natural person, a corporation does not always have the capacity to do whatever it wants. Corporate capacity may be limited by what the governing statute, the constitutive documents, and particularly the objects clause, authorize the corporation to do. Anything else would be *ultra vires* – that is, beyond the capacity of the corporation and void or voidable at common law – potentially putting the directors who sanctioned such transactions in breach of their duties.

[63] The doctrine of *ultra vires* is a blunt instrument, and at best can only nullify contracts which exceeded the capacity of a corporation. Inequities are also exacerbated by the fact that the application of the doctrine does not depend on whether the third party who has contracted with the corporation had actual knowledge of the corporation's lack of capacity. According to the doctrine of constructive notice, anyone dealing with a registered corporation is deemed to have had notice of the contents of public constitutive documents which are available for inspection.[58]

[58] The doctrine of indoor management limited the effect of the doctrine of constructive notice by providing that outsiders were entitled to presume that internal requirements prescribed in those documents have been properly observed.

[64] By the time new for-profit incorporation legislation was being considered in the 1970s, it was obvious that the doctrine of *ultra vires* should be abandoned, and that modern devices should be developed to protect creditors and shareholders from improper or profligate activity on behalf of management. To this end, the general approach was to confer on corporations all the powers, rights and privileges of a natural person. From then on business corporations had the capacity to do anything they wished, unless otherwise provided in their governing statute or documents. Over the last years, there have been calls to abolish the doctrine for non-profit corporations as well.

[65] The doctrines of *ultra vires* and constructive notice are largely obsolete in modern corporate law. More recent non-profit corporate statutes, such as the CNCA, now include provisions which effectively neutralize the effect of those doctrines:

> **Powers of a corporation**
>
> **17.(1)** It is not necessary for a by-law to be passed in order to confer any particular power on a corporation or its directors.
>
> **Restricted activities or powers**
>
> **(2)** A corporation shall not carry on any activities or exercise any power in a manner contrary to its articles.
>
> **Rights preserved**
>
> **(3)** No act of a corporation, including any transfer of property to or by a corporation, is invalid by reason only that the act or transfer is contrary to its articles or this Act.
>
> **No constructive notice**
>
> **18.** No person is affected by or is deemed to have notice or knowledge of the contents of a document concerning a corporation by reason only that the person can examine it under section 279 or at an office of the corporation.

[66] On balance, we think that the doctrine of *ultra vires* has done more harm than good and that it should be abolished by making it clear that no act of a corporation is invalid by reason only that it is beyond the scope of its corporate powers. Similarly, steps should be taken to remove any remnants of the doctrine of constructive notice.

[67] Even without the doctrine of *ultra vires*, non-profit corporations still have to comply with the requirements, formalities and procedures set out in their statute and other governing documents, such as the articles of incorporation or

by-laws. This creates both external and internal "checkpoints" which help define the rights, obligations and roles of the management and constituency.[59]

RECOMMENDATION 10

The doctrines of *ultra vires* and constructive notice should be abolished.

2. POWERS

ISSUE 4

Should non-profit corporations have all the powers, rights and privileges of a natural person? (Recommendation 11)

[68] Like business corporations, non-profit corporations need to be able to contract with suppliers, rent space, buy equipment, take loans, etc. Corporate powers are legal tools used by a corporation to carry out these day-to-day activities. The current legislative trend is to provide non-profit corporations with all the powers, rights and privileges of a natural person, and to leave those powers, rights and privileges unrestricted, unless otherwise provided by the governing statute or documents.[60]

[69] Directors and officers can generally use the powers granted to the corporation as they think fit. In some cases, however, non-profit corporate legislation provides that those powers must be exercised only to further the corporation's purpose. [61] For instance, Nova Scotia's *Community Interest Companies Act*, section 13(1)(c) provides that community interest companies, which have all the powers, rights and privileges of a natural person, cannot transfer any of their assets other than in furtherance of the community purpose set out in their articles.[62] Whether such requirements effectively promote

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[59] Powerful incentives to comply with requirements found in other statutes, such as gaming license, fundraising registration, tax exemptions, also act as checkpoints.

[60] Section 16 of the CNCA provides:

> **Capacity of a corporation**
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> **16(1)** A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person.

[61] Section 17 of the *Societies Act* provides that any funds (presumably including any investment) must be used to further the society's objects. Sections 18-19 state that societies can borrow money and give guarantees for the purpose of carrying out their objects.

[62] *Community Interest Companies Act*, SNS 2012, c 38 (not yet in force).

adherence to purpose and good governance, or simply reduce the ability of directors or officers to meet changing needs and circumstances, is debatable.

[70] In addition, the exercise of corporate powers can be subject to specific formalities. For instance, under the *Societies Act* directors must not only use their power to borrow money and give guarantees in furtherance of the corporation's purpose, but must also obtain the approval of members by special resolution.[63] The CNCA no longer requires member authorization to borrow or grant security. However, corporations can choose to provide otherwise in their governing documents.[64] There are many examples of corporate powers that carry formalities: corporate seal, execution of documents, annual financial statements, nomination of directors, notice of meeting to members, etc.

[71] We do not think that the act should impose any restrictions or limitations on non-profit corporations' powers. However, a corporation should be free to restrict or limit the powers of its directors and officers if it so chooses. Generally, any restrictions on the powers (or activities) of a corporation should be contained in the articles, while formalities on how to exercise those powers should be in the by-laws.

[72] The act should however make clear that third parties dealing with a corporation – assuming that they are acting in good faith and without knowledge of any irregularity – need not inquire about the formality of the internal proceedings of the corporation, but are entitled to assume that there has been compliance with the articles and by-laws (indoor management rule).[65]

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[63] The *Companies Act* does not require a special resolution. None of the Saskatchewan, Ontario or Federal non-profit legislation requires that a special resolution be passed before a debenture is issued. The rationale is that this is a matter that would fall under a director's general grant of authority to supervise the management of the affairs of the corporation. See also British Columbia Law Institute, *Proposals for a New Society Act*, Consultation Paper (August 2007) at 95, available online at: <www.bcli.org/sites/default/files/Society_Act_Consultation_Paper_0.pdf, at 95> [BCLI Consultation].

[64] CNCA, s 28.

[65] For example, the CNCA provides that:

> **Authority of directors, officers, agents and mandataries**
>
> **19(1)** No corporation, no guarantor of an obligation of a corporation and, in Quebec, no surety may assert against a person dealing with the corporation or against a person who acquired rights from the corporation that
>
> (a) the articles, the by-laws or any unanimous member agreement has not been complied with;
>
> (b) the individuals named in the last notice that was sent by the corporation in accordance with section 128 or 134 and received by the Director are not the directors of the corporation;
>
> (c) the place named in the last notice accepted by the Director under section 20 is not the registered office of the corporation;
>
> (d) a person held out by a corporation as a director, an officer, an agent or a mandatary of the corporation has not been duly appointed or has no authority to exercise the powers and perform
>
> *Continued*

RECOMMENDATION 11

Non-profit corporations should have all the powers, rights and privileges of a natural person, unless a corporation chooses to restrict, circumscribe or control the use of these powers. To better protect innocent third parties, the new act should codify the indoor management rule.

3. PURPOSES

ISSUE 5

Should non-profit corporate legislation restrict the incorporation purpose? Should a statement of purpose be required? (Recommendations 12 and 13)

[73] The purpose of an organization is the reason for which it is incorporated; it is the outcome that is intended and the aim toward which the corporation strives. The purpose defines goals, directs actions and efforts, and establishes targets against which results can be measured and reported. For instance, a corporation's purpose may be to reduce the incidence of poverty among Albertans with physical or cognitive disabilities. Of course, there are many things that can be done to effectuate that purpose, such as providing housing, transportation, education, training or employment. However, the purpose itself remains poverty reduction for the disabled in Alberta, regardless of how the corporation chooses to achieve it.

[74] Non-profit corporate legislation commonly restricts incorporation to purposes that are considered non-profit in nature. However, as non-profit purposes encompass basically everything but profit, those statutes merely set out blanket categories of permitted purposes, such as philanthropic, charitable, religious, scientific, cultural, recreational, social, educational, political, professional, agricultural, or any other useful purpose.[66]

[75] The problem is that a statutory restriction on purpose says nothing about the reason for incorporation except that it falls within broadly enumerated

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the duties that are customary in the activities of the corporation or usual for a director, an officer, an agent or a mandatary;

(e) a document issued by any director, officer, agent or mandatary of a corporation with actual or usual authority to issue the document is not valid or not genuine; or

(f) a sale, a lease or an exchange of property referred to in subsection (1) was not authorized.

Exception

(2) Subsection (1) does not apply in respect of a person who has, or ought to have, knowledge of a situation described in that subsection by virtue of their relationship to the corporation.

[66] See *Societies Act*, s 3(1); see also *Companies Act*, s 200(1).

purposes. As a result it has been common to add a further restriction related to "carrying on a business". However, that restriction has sometimes been construed so as to limit non-profit corporations' ability to engage in commercial or revenue-generating activities as a way to achieve non-profit purposes.

[76] Restricted purposes have been a hallmark of non-profit corporate law. A restriction can be expressly imposed in the incorporation statute or flow from the statement of purpose of the corporation. Such devices may help to strengthen the non-profit identity of a corporation, but also impose the responsibility to stay within the boundaries that this sets.

[77] Lately, however, restricted purposes appear to have lost favour in non-profit corporate legislation. For example, under the CNCA, corporations have unrestricted purposes.[67] This can be interpreted as indicating that non-profit corporations are now free to do business in any area they chose.

[78] The question is whether maintaining restricted purposes effectively ensures that corporations are constituted for non-profit purposes and strengthens their identity, or unduly constrains non-profit corporations without offering any real benefit. On balance, we do not think that it is any longer worthwhile to so enumerate the said non-profit purposes in the act. Corporations without share capital should be allowed to be formed for any lawful purpose, as long as that purpose is not to distribute income or capital to shareholders/members on operations.[68] Restrictions should focus on the distribution of assets during existence, not on the purposes of incorporation.[69]

RECOMMENDATION 12

The new act should not define or list purposes of incorporation. Neither should it restrict incorporation to specific enumerated purposes. Organizations should be able to incorporate for any lawful purpose.

[79] Non-profit corporate legislation should not impose any restrictions on the purposes of incorporation, and the purpose of a non-profit organization should be left to the organization.[70] But there may be a middle position: the act could

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[67] CNCA, ss 6-7.

[68] As discussed below, this is where the distinction between a for-profit corporation and a non-profit corporation really lies.

[69] See the *Asset Distribution* section below.

[70] To be registered as charity with the CRA, non-profit organizations have to describe their charitable purpose. This means that corporations seeking charitable status must have a statement of purpose in their

Continued

allow incorporation for any lawful purpose, but require a non-profit society to specify their purpose as part of the incorporation process. In its report, the British Columbia Law Institute recommended this approach be taken in the province as it provided for both flexibility and transparency.[71]

[80] A purpose statement is an essential part of a non-profit corporation.[72] Because it entails describing the aim or main intent of the corporation with more precision, a statement of purpose furthers internal cohesion by forcing the organization to think about what it intends to do and why it is relevant. A cohesive organization is able to make more efficient and focused use of resources which contributes to a heightened level of trust. This, in turn, increases its ability to attract and retain directors, members, funders, donors and volunteers. In addition, a stated purpose provides a benchmark against which to measure results.

[81] As long as the legal function of this device is clear, a stated purpose may also be a way to give content to corporate rights and obligations.[73] Some people suggest that the statement of purpose acts as a mechanism for internal control and helps in preventing misuse of resources and in controlling mission drift. However, others are of the view that non-profit corporations do not need to describe the reason for incorporation but should be free to include a statement of purpose in their articles if they so choose.[74] While this position has the advantage of offering a great deal of flexibility, it leaves no way to make sure that non-profit

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constitutive documents, whether or not the corporate statute requires doing so. However, guidance with respect to charitable purposes should not be in the legislation itself but in the accompanying materials. As it was done in Ontario, Service Alberta could get pre-approved purposes from the Charities Directorate of the CRA and direct organizations that want to register as charities to these pre-approved purposes.

[71] BCLI Report.

[72] Under the *Societies Act*, the purpose of incorporation has to be reviewed and approved by the corporate authorities. The corporate authorities have the power to direct applicants to strike out or modify their stated purpose. Subsequent changes to purposes must also be reviewed and approved to become effective: see *Societies Act*, ss 10-11. Beyond that, however, there is no monitoring power to ensure that the societies are operated for the purposes for which they are incorporated. For instance, the corporate annual return does not include any affirmation of whether the corporation is adhering to its purpose.

[73] For instance, a stated purpose may help to delineate the duties of the directors, such as the duty of obedience or fidelity, and rights of the members, such as the right to vote on fundamental changes. It should be clear that this is meant to provide a mechanism for internal control, and not a premise for the application of the doctrine of *ultra vires*.

[74] See Don Bourgeois, "Three Views on Bill C-21: Canada Not-For-Profit Corporations Act", *The Philanthropist*, 21:1 (2007), at 80, available online at: <www.thephilanthropist.ca/index.php/phil/article/download/18/18>.

corporations stay true to their purpose, whatever it might be, and consult their constituents should there be any departure from this purpose.[75]

[82] But what are the consequences for failing to follow a stated purpose? We previously recommended the abolition of the doctrine of *ultra vires*. The challenge is therefore to create a mechanism for internal controls without allowing an attenuated version of the doctrine of *ultra vires* to be reincorporated into non-profit corporate law. No act of a corporation should be invalid only because that act is outside of the stated purpose of the corporation.

[83] Checks and balances are essential but those are part of the role of the membership. We think that it should be up to members who believe that the stated purpose was deviated from to trigger the internal remedy. In all cases, there should be enough members agreeing to initiate a review process.[76] The question of whether the corporation has acted outside the stated purpose could be submitted and discussed at an annual or special meeting if a prescribed percentage of members signed the proposal (e.g. at least 10%). If necessary, another vote could be taken to decide whether to approve or confirm the decision made in deviation from the stated purpose.[77] Ultimately, directors can be voted out for overstepping the stated purpose at the annual meeting.[78]

[84] It has been suggested that this type of internal constraint can impede management if directors end up spending meetings discussing what is inside and outside the stated purpose and whether they may need membership approval. To alleviate this sort of issue, we are therefore proposing a "business judgment rule", where management can be further protected if it relies on written professional advice. We feel that this mechanism will motivate directors to abide by the stated purpose, and encourage management to lay out concrete plans.

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[75] As noted in ALRI Report 49, at 33:

> The *Business Corporations Act* does not require that the purposes of a corporation be stated. We think, however, that for this purpose there is a material difference between a business corporation and an incorporated association. A business corporation is formed for the generalized purpose of economic gain for its members and economic efficiency is best served by leaving it free to do whatever is profitable. A non-profit association, however, is usually formed for a specific purpose to which its members and, in the case of a charity, those who have donated money and effort to it, should be able to confine its activities.

[76] As discussed below, member rights should be collectively exercised. See *Members' Roles and Rights* section.

[77] This could also trigger an amendment to the articles to change the stated purpose. See discussion in the *Members' Roles and Rights* section below.

[78] In the UK, companies no longer have to register objects under the *Companies Act 2006*, and even if they do the doctrine of *ultra vires* has been abolished against third parties. The stated purpose is only relevant in a complaint against directors or officers for breach of duty when they have failed to act in accordance with that purpose. See *Companies Act 2006* (UK), c 46, ss 31, 39, 42, 171.

[85] Mediation and arbitration should be encouraged as a way to resolve disputes about stated purposes or as a second level of review.[79] However, external remedies, such as court challenges or government controls, should be avoided as they would only put a strain on resources.

RECOMMENDATION 13

Non-profit corporations should be required to include a statement of purpose in their articles. A deviation from the stated purpose should trigger only internal controls.

4. ACTIVITIES

ISSUE 6

Should non-profit corporations be allowed to engage in commercial activities? (Recommendation 14)

[86] It is important to distinguish between a corporation's purpose and activities. The activities describe the way the corporation will accomplish its purpose. Thus even a restricted purpose does not necessarily limit the activities the corporation can carry out to further that purpose. In our previous example, to reduce the incidence of poverty among Albertans with physical or cognitive disabilities, the non-profit organization may choose to operate thrift stores both to provide training and employment for disabled people, and to generate funds to help achieve its mission.

[87] Non-profit legislation generally provides that organizations cannot be incorporated primarily to pursue a business purpose. This is often construed as a restriction on a non-profit corporation's ability to carry out regular or continuous commercial activities. For instance, section 3(1) of the *Societies Act* states that: "Five or more persons may become incorporated under this Act for any benevolent, philanthropic, charitable … or other useful purpose, *but not for the purpose of carrying on a trade or business"* [emphasis added]. This provision is interpreted as meaning that organizations incorporated under the Act cannot engage in any business operations of significant or permanent nature.[80]

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[79] Mediation and arbitration are further discussed in the *Corporate Remedies* section.

[80] See, for example, The Muttart Foundation, *Drafting and Revising Bylaws for Not-for-Profit Organizations in Alberta* at 11 and 61, online: <www.muttart.org/sites/default/files/downloads/publications/drafting_revising.pdf>.

[88] Although the aim of this type of restriction is to ensure that running a business does not become a purpose in its own right, it also limits what a non-profit organization can do to deliver expected benefits to the target clientele and/or to diversify sources of funding.[81] Maybe this is simply the result of confusing the purpose of a corporation with the activities it undertakes to achieve that purpose. But the question is whether it is possible to leave corporations free to decide how to best accomplish what they set out to accomplish without blurring the lines between for-profit and non-profit corporations.

[89] A business generally involves commercially producing, distributing, selling or otherwise providing goods and services in the marketplace. Whether a particular activity is considered a business depends on the facts and circumstances of each case.[82] There are different reasons why a non-profit organization may choose to actively engage in a business operation. A commercial activity in and of itself is sometimes the means chosen to achieve a non-profit purpose.[83] Such an undertaking focuses on improving economic opportunities and social conditions of an identified group or community, and is often done on a cost-recovery basis. In most cases, however, a commercial activity is carried out to generate funds for the organization.[84] Either way, this may not be a concern if the commercial activity remains subordinated to a non-profit purpose in the context of the organization's operation as a whole, and does not unduly divert resources and attention from that purpose.

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[81] This is especially questionable considering that other statutes which give non-profit organizations access to competitive advantage do not impose blanket restrictions on business operations. Under the *Income Tax Act*, for instance, organizations which carry out community development activities and/or related business activities may qualify for charitable registration as long as all their activities further charitable purposes. The *Income Tax Act* also contains certain restrictions on political activities for registered charities. See Canada Revenue Agency, Policy Statement CPS-022, "Political Activities" (effective 2 September 2003), available online at: <www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-022-eng.html>.

[82] For instance, holding fundraising events of a particular type, such as a bake sale, concert, dance or golf tournament, could be considered a business activity, but not amount to carrying on a business if it is not a continuous or regular commercial operation.

[83] This includes, for example, activities seeking to offer employment or training to disadvantaged groups or to improve socio-economic conditions in an area of social and economic deprivation. Organizations that carry out community economic development activities may be eligible for charitable registration under the ITA if all their activities further charitable purposes.

[84] Registered charities under the *Income Tax Act* can carry on a related business which furthers their charitable purposes. The CRA defines a related business as a commercial activity that is either linked and subordinated to the charity's purpose or substantially run by volunteers. Some non-profit organizations do not have charitable – or at least exclusively charitable – purposes and cannot register for charitable status. Nonetheless, those organizations that pursue a purpose other than profit may still qualify for tax exemption.

[90] A commercial activity has the potential to yield profit. Therefore, a restriction on the use of profit may also be a way to ensure that any surplus derived from a commercial activity is applied to the corporation's purpose. For instance, the *Companies Act* provides that it must be "the intention of the association to apply the profits, if any, or any other income of the association in promoting its objects".[85] This type of restriction does not in and of itself guarantee that a revenue-generating activity is incidental or ancillary to any non-profit purpose.[86] It implies, however, that when an organization is incorporated for a specific purpose, it is must devote its resources to that purpose and no other.

[91] It has been suggested, however, that corporations which are too "profitable," especially those that engage in a commercial endeavour, may be more economically sustainable but may more easily drift away from the type of work preferred by their stakeholders. Some also argue that this may also increase the risk of opportunistic alteration of purpose. Though we agree that those risks are real, we think that they can be lessened if appropriate checkpoints and safeguards are put in place, such as the necessity to retain stated purpose as an element of a non-profit corporation. Good governance should also come into play as the continued trust and support of funders, donors, volunteers and members require that an organization have in place ways to track where funds come from and how they are being used to further their mission.

[92] It may seem incongruous for non-profit corporations to carry on a trade or business with the aim of making a profit. Nonetheless, non-profit corporations, like any other corporations, have to be sustainable. Whereas business corporations seek to make a surplus for the benefit of their shareholders, non-profit corporations only need to ensure that the pursuit of their stated purpose remains financially viable. But we are also sensitive to the fact that allowing organizations to undertake revenue-generating ventures may be perceived as a

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[85] *Companies Act*, ss 200(1) and 202(1). Similar restrictions on the use of proceeds are found in other statutes. For instance, under the *Gaming and Liquor Act*, RSA 2000, c G-1, s 91 and *Gaming and Liquor Regulation*, Alta Reg 143/1996, an organization must state in its application how it will use gaming proceeds prior to receiving its licence to ensure that those proceeds are only used for purposes essential to the delivery of the organization's approved program.

[86] Focussing solely on the use of profit can indeed be misleading. Earning revenues to fund non-profit activities is not in itself a non-profit purpose. For instance, recent CRA interpretations seem to indicate that organizations may be considered to have a profit purpose if they undertake activities with the intention to realize a gain, regardless of what the intentional profit is used for. However, many commentators believe this approach is wrong because it does not reflect the reality of how non-profit organizations are operated and confuses the purpose of an activity with the purpose of the organization.

threat to the non-profit identity. On balance, however, we think that non-profit corporations should be able to engage in commercial activities that support their stated purpose and that this choice should be left to the organizations. Though it is true that this capability may disqualify them under other statutes, it should be up to the individual organizations – not the legislation – to put appropriate restrictions on those activities in their articles where needed (e.g. non-profit organizations that wish to obtain tax-exempt status). However, it may still be useful to provide educational material on the provincial website for guidance on business activities and tax exemption.

[93] As discussed above, the purpose of a non-profit corporation is, generally speaking, to have a purpose other than making money for the personal benefit of its members. The qualifier "non-profit" refers to the structure of the corporation (i.e. non-share capital) and not to the ability to generate surpluses or accretions through its activities. A corporation should be free to carry on the activities it wants in support of that purpose so long as it does so in a non-profit context as defined by the incorporation statute. In other words, there is no need for restrictions on commercial activities if no personal distribution is permitted. The focus should not be on whether or not a non-profit corporation should be allowed to make a surplus but on whether or not it should be allowed to distribute that surplus.

RECOMMENDATION 14

Non-profit corporations should be allowed to engage in commercial activities that are incidental or ancillary to their stated purpose.

5. ASSET DISTRIBUTION

ISSUE 7

Should non-profit corporations be restricted from distributing income or property to members during its existence? Upon dissolution? (Recommendation 15)

[94] A for-profit corporation is expected to strive to augment the wealth of its shareholders by increasing dividend payments and/or share prices. The shareholders are the corporation's owners and have different rights depending on their class of shares. These rights include the right to elect and dismiss directors, to vote on major issues and changes, to dividends if declared, to a

share of equity, to transfer ownership, and to what assets remain upon liquidation and dissolution.[87] However, some of the above rights do not sit well with the non-profit corporate model, especially those related to the distribution of income and capital.

[95] In general, the purpose of non-profit corporate legislation is to allow the incorporation or continuance of bodies corporate without share capital.[88] But can individuals still have an economic stake in a non-profit corporation? In our example, would it be an issue if the non-profit corporation offered to its disabled employees the opportunity to become shareholders of the thrift stores they work for? There is a long-standing principle that a non-profit corporation cannot be structured to maximize shareholder value. So most non-profit corporate statutes contain restrictions on share capital and payment of dividends. For instance, the *Societies Act* provides that: "No society shall have a capital divided into shares or declare any dividend".[89]

[96] However, sometimes paying investment returns is not the purpose of a corporation but a way to attract private capital for a non-profit purpose; the question is whether this may be allowable.[90] For example, it may be acceptable for a non-profit corporation to pay a small dividend to investors, as long as the rate of interest is fixed and not related to the corporation's profit.[91] There are also

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[87] The issue of voting rights is treated in more detail in the *Members' Roles and Rights* section below.

[88] For example, the CNCA provides that:

> **Purpose**
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> **4.** The purpose of this Act is to allow the incorporation or continuance of bodies corporate as corporations without share capital, including certain bodies corporate incorporated or continued under various other Acts of Parliament, for the purposes of carrying on legal activities and to impose obligations on certain bodies corporate without share capital incorporated by a special Act of Parliament.

[89] See *Societies Act*, s 4(1).

[90] See *Business Corporations Act*, SBC 2002, c 57, Part 2.2; *Community Interest Companies Act,* SNS 2012, c 38 (not yet in force). See also Richard Bridge and Stacey Corriveau, *Legislative Innovations and Social Enterprise: Structural Lessons for Canada*, February 2009, available online at: <www.centreforsocialenterprise.com/f/Legislative_Innovations_and_Social_Enterprise_Structural_Lessons_for_Canada_Feb_2009.pdf>.

[91] There are levels of ownership which accompany the main classes of securities that a corporation can issue: common shares, preferred shares and bonds. Some of those do not include any right to vote and/or right to a share of equity. For instance, if equity capital is the real problem, it may not be necessary to exclude other forms of private financial investment or arrangement, such as bonds and low- or no-interest loans. As Linda Sugin points out:

> The non-distribution constraint that characterizes nonprofit organizations is the consequence of the adherence to mission, not vice versa. The constraint guarantees that the organization will be operated to achieve its mission, and never for the benefit of shareholders or other private interests. As soon as profits can be paid out to individuals, the role of directors becomes unclear and conflicted. No board can simultaneously treat its charitable mission and its shareholders' private pecuniary interests as paramount.

See Linda Sugin, "Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity" (2007) 76 Fordham L Rev 893 at 918, available online at: <ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4315&context=flr>.

various forms of financial arrangements which can be used to raise capital, such as low- or no-interest loans.[92]

[97] The non-distribution constraint is not limited to individuals who have ownership rights in the corporation; it also extends to those who exercise control over it. There is therefore another principle that income and property cannot flow from a non-profit corporation to its members, directors or officers.[93] Such payments are generally restricted during the existence of the corporation. Modern non-profit corporate legislation does not generally prohibit the payment of remuneration to directors, officers and employees of a corporation - whether as directors, officers or employees or in any other capacity (e.g. in the capacity of consultants). This means that directors are entitled to fix reasonable levels of remuneration of directors, officers and employees, unless otherwise provided in the governing documents of the corporation. Certain restrictions may apply to registered charities. The restriction is designed to ensure that those who oversee the non-profit corporation have no pecuniary incentive to advance their own interests rather than those of the corporation. For instance, the *Societies Act* provides that no society shall "distribute its property among its members during the existence of the society."

[98] Those are all ways to make sure that resources and attention are devoted to the non-profit purpose. However, the question is whether there should be exceptions to such blanket restrictions based on the type of non-profit corporation and other practical considerations.[94] For example, it may be appropriate for a mutual benefit corporation, such as a private golf club, to distribute assets among "equity" members on winding up.[95] It may also be

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[92] For example, section 234 of the CNCA clearly provides that: "If a person has transferred property to a corporation subject to the condition that it be returned on the dissolution of the corporation, the liquidator shall transfer that property to that person."

[93] See *Societies Act*, s 4(1); *Companies Act*, ss 200(1) and 202(1). See also CNCA, s 34(1).

[94] The answer to that question may depend on whether the corporation is a member benefit or public benefit organization, or on whether the organization wishes to receive favourable tax treatment and/or other incentives. To be truly enabling the legal framework needs to provide the guidance which will allow organizations to include the non-distribution clause(s) in their governing documents in accordance with their needs and circumstances. Moreover, it may be necessary to make clear that this restriction does not prevent the payment of reasonable salaries or other forms of compensation for goods or services provided by members, directors or officers for the normal operation of the corporation, or private benefit that is incidental to achieving the non-profit purpose of the corporation (i.e. members who are eligible beneficiaries of a program).

[95] Although most statutes are silent on the question, the distribution of assets to members upon dissolution may be an issue, especially for those organizations that hope to qualify for charitable registration under the *ITA*. See also Part H, *Fundamental Changes*.

acceptable for a big corporation to pay compensation to its staff and directors, as long as it is not to support unreasonable salaries or spending.

[99] It may indeed be useful to relax the blanket prohibition on asset distribution. However, we think that certain restrictions should be maintained in order to keep the line of demarcation clear between non-profit and for-profit corporations. There also seems to be a strong consensus on the necessity of restricting asset distribution for the personal benefit of members during the existence of a non-profit corporation. Therefore, to allow the smooth transition of all types of organizations, especially non-profit companies (Part 9 of the *Companies Act*), the new act should mandate no distribution on operations but leave the option for capital to go back to members on dissolution.

[100] To this end, the act should establish a "two-part model", that is: (1) fully restricted corporations, and (2) partly restricted corporations. Generally speaking, mutual benefit organizations, that is, non-profit corporations created primarily for the benefit of their members, should have the choice to incorporate under either part; public benefit organizations should incorporate as fully restricted corporations. Organizations should be able to self-assess their status as public or mutual benefit bodies and indicate whether they will be fully or partly restricted by checking the appropriate box when applying for a certificate of incorporation (or restricting distribution under their articles).

[101] Corporations may want – or may have to – reassess their status if their circumstances change.[96] A corporation which started as a partly restricted corporation could become fully restricted. This would however be a one-way trip; the organization could not go back to partly restricted.[97] On the other hand, a corporation set up as fully restricted could not become partly restricted. This would mean, for instance, that a subsequent generation membership could not make it distributing on dissolution.

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[96] For instance, subsection 2(9) of the Saskatchewan Act provides that:

> **2(9)** A corporation other than a corporation mentioned in Division XV of Part II is deemed to be a charitable corporation where, after incorporation or continuance pursuant to this Act, the corporation:
>
> (a) carries on activities that are not primarily for the benefit of its members;
>
> (b) solicits or has solicited donations or gifts of money or property from the public;
>
> (c) receives or has received any grant of money or property from a government or government agency in any fiscal year of the corporation that is in excess of 10%, or any greater amount that may be prescribed, of its total income for that fiscal year;
>
> (d) is a registered charity within the meaning of the Income Tax Act (Canada).

[97] This is what the CNCA tried to achieve in making a distinction between "soliciting" and "non-soliciting".

[102] Organizations incorporated under Part 1 would not have the ability to distribute income or capital of the corporation on operations or dissolution. However, the payment of a fee for services as a director should not be prohibited, except when otherwise provided in an organization's governing documents. Part 2 would also restrict distribution during existence but leave the option for capital to go back to members on dissolution, with tax consequences. Since organizations incorporated under the act would be corporations without share capital, distribution would have to be on a membership basis, not on a share basis.[98] Membership would also be transferable.[99]

[103] Although we recognize that enabling non-profit corporations to access diverse and steady sources of funding may contribute to their sustainability, we do not think that further accommodations, such as allowing the payment of returns to investors, are warranted. This is not to say that corporations with "social purposes" should not be allowed to pay dividends to investors to attract private capital. However, we think that this issue may be better addressed in parallel amendments to the *Business Corporations Act*. The question of whether Alberta legislation should provide for the incorporation of social enterprises, that is, a corporate structure which allows distribution during existence in the form of fixed dividends or interest but no distribution of capital on dissolution, is beyond the scope of this Report for discussion.[100]

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[98] Part 9 companies continuing under the new act would have to convert into a corporation without share capital. For example, the CNCA provides that:

> **Continuance — import**
>
> **211.(1)** A body corporate incorporated or continued otherwise than by or under an Act of Parliament may apply to the Director for a certificate of continuance if so authorized by the laws of its jurisdiction and if the body corporate satisfies, or by its articles of continuance would satisfy, the requirements for incorporation under this Act.
>
> **Amendments in articles of continuance**
>
> **(2)** A body corporate that applies for a certificate under subsection (1) may, without so stating in its articles of continuance, effect by those articles any amendment to its act of incorporation, articles, letters patent or memorandum or articles of association that a corporation incorporated under this Act may make to its articles.
>
> **Share capital**
>
> **(3)** If the body corporate is a body corporate with share capital, it shall establish the terms and conditions on which it is converted to a body corporate without share capital.

[99] Membership could be purchased on the market or bought back by the corporation in the course of its operations. This issue is further discussed in the *Members' Roles and Rights* section.

[100] A social enterprise – also known as community interest company or community contribution company (C3) - is a business corporation which is obligated to devote most of the revenues it generates to community development, but able to pay stakeholders a limited return on their investments (i.e. cap on payment of dividends or interest and on purchase or redemption of shares). Generally, C3's notice of articles must include a statement indicating that the company has purposes beneficial to society, and is restricted in its ability to pay dividends and distribute assets on dissolution; if the notice of articles is altered to remove that statement, the company then ceases to be a C3. A C3 is subject to greater transparency, public accountability and government regulation than ordinary companies. For instance, a C3 will be required to produce

Continued

RECOMMENDATION 15

The new act should be organized into a two-part model: (1) fully restricted corporations (distribution restricted during existence and on dissolution), and (2) partly restricted corporations (distribution restricted during existence but not on dissolution). Organizations should be required to indicate their election in the articles of incorporation when applying for a certificate of incorporation.

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financial statements and publish annual community contribution report detailing its social and community investments. Finally, there is also an "asset lock" to ensure that profits are retained by the company or directed to the community benefit (i.e. no transfer of assets at less than market value and no distribution of capital to shareholders on dissolution). See *Business Corporations Act*, SBC 2002, c 57, Part 2.2; *Community Interest Companies Act*, SNS 2012, c 38 (not yet in force). See also Richard Bridge and Stacey Corriveau, *Legislative Innovations and Social Enterprise: Structural Lessons for Canada*, February 2009, available online at: <www.centreforsocialenterprise.com/f/Legislative_Innovations_and_Social_Enterprise_Structural_Lessons_for_Canada_Feb_2009.pdf>.

CHAPTER 3

Directors' and Officers' Duties and Liabilities

[104] As the non-profit sector takes on an increasingly important role in Alberta, there are calls for greater public accountability. Many non-profit board members, however, may be unaware of or unclear about their duties and liabilities. Motivated by a desire to be committed volunteers who contribute to their community or member organizations, board members risk personal liability if they do not adequately fulfill their duties and responsibilities. [101] The question is how to find a happy medium between holding directors and officers accountable and providing appropriate protection from liability?[102] While legislation is not the only tool for promoting good governance, it can assist in achieving the appropriate balance.

[105] Currently, Alberta's non-profit corporate legislation provides little guidance on the duties or liabilities of directors or officers. Accordingly, one must look to the common law and an organization's by-laws or other constitutive documents to determine what they are. The lack of legislative standards in this area has certain drawbacks. First, it may be difficult to ascertain what the duties and liabilities are at common law and the case law may introduce complexities that are not appropriate to all non-profit corporations. Second, the contents of by-laws or constitutive documents may differ from organization to organization and may not reflect baseline standards of conduct that should be common to all directors, regardless of the organization.

[106] Other Canadian jurisdictions have responded to similar shortcomings in their non-profit corporate legislation by importing the standards for directors and officers found in the for-profit sector. This approach has some advantages in that the non-profit sector can benefit from the wealth of existing jurisprudence around the interpretation and application of these standards. However, are the

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[101] The Law Reform Commission of Saskatchewan, *Liability of Directors and Officers of Not-for-Profit Organizations*, Final Report (February 2003) at 2, available online at: <www.lawreformcommission.sk.ca/directorsfinal.htm> [Saskatchewan Report].

[102] Saskatchewan Report at 2.

standards developed in the for-profit sector appropriate for the non-profit sector?[103]

A. Directors and Officers

ISSUE 8

Should the terms "director" and "officer" be defined in the non-profit corporate legislation? (Recommendations 16 and 17)

[107] The board of directors as a whole is responsible for the governance and management of the corporation.[104] Generally, the roles and responsibilities of the board include:

- complying with the corporation's purpose,
- adopting, amending and repealing by-laws,
- developing and implementing corporate policy,
- providing strategic planning,
- securing the funding necessary to carry out annual operating goals,
- approving budgets and financial statements,
- borrowing money and granting security on the property of the corporation,
- electing or appointing officers to assist them, and
- supervising senior staff.

[108] Directors generally meet on a regular basis to oversee the conduct of the corporation's operations. Special meetings of the directors may occasionally be needed. The by-laws of the corporation should usually deal with matters such as frequency of meeting, notice of meeting, quorum, telephone or electronic meetings, resolutions in writing, and decision by consensus. As previously

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[103] Linda Sugin, "Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity" (2007) 76 Fordham L Rev 893 at 905.

[104] The legislation sometimes set out a minimum number of directors. For instance, section 125 of the CNCA provides that: "A corporation shall have one or more directors, but a soliciting corporation shall not have fewer than three directors, at least two of whom are not officers or employees of the corporation or its affiliates".

discussed, however, we think that the act should set out default provisions to settle operational issues that are not already regulated by the corporation's by-laws.[105]

[109] The notice of directors that must be filed with the application for a certificate of incorporation names the individuals who will compose the first board of directors of the corporation.[106] The individuals will act as directors of the corporation from the issuance of the certificate of incorporation until the first meeting of members.[107] At that meeting, the members elect the directors of the corporation – who may be chosen from the first directors, members or other individuals – for a term that does not exceed the period prescribed in the legislation or the by-laws.[108] From then on, members will elect additional directors, re-elect directors whose terms have expired, or choose new directors to replace existing ones.[109] Directors are generally elected by a majority of the votes cast at an annual meeting of the members.[110]

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[105] See, for example, CNCA, ss 136(2) (quorum), 136(3) (notice of meeting), 136(7) (telephonic or electronic participation), 137 (decision by consensus) and 140 (resolution in writing).

[106] After incorporation, the first directors are required to call an organizational meeting to adopt a number of resolutions which will allow the corporation to conduct its corporate activities and affairs. Matters that the first directors have to deal with include making by-laws; adopting forms for corporate records and debt obligation certificates; authorizing the issuance of debt obligations; appointing officers; appointing an interim public accountant to hold office until the first meeting of members; issuing memberships; making banking arrangements; and transacting any other business. Alternatively, instead of holding a meeting, the directors may sign organizing resolutions to deal with these matters.

[107] The first directors must call a meeting of the members within the prescribed period (i.e. 18 months of the date of incorporation). Matters that the members have to deal with at that first meeting include electing directors; confirming, modifying or rejecting the by-laws established by the first directors; appointing a public accountant, who can be the same one appointed by the first directors or a different one; adopting special by-laws, if any; and transacting other business. Similar to the first meeting of the directors, the members may also sign organizing resolutions, instead of holding a meeting.

[108] When no term is stated, directors cease to hold office at the end of the next annual meeting of members. If directors are not elected at that meeting, the incumbent directors may continue until their successors are elected. Directors can be re-elected at the end of their term, unless otherwise provided in the by-laws.

[109] Statutory provisions sometimes permit a vacancy on the board to be filled by directors until the next annual meeting. The articles of incorporation may also allow the directors to appoint additional directors until the next annual meeting of members; the total number of appointed directors is generally limited to one-third of the number of directors elected at the previous annual meeting. See, for example, CNCA, ss 128(8) and 132.

[110] The governing documents of a corporation may provide that a particular class or group of members has an exclusive right to elect one or more directors. A director elected by a class or group of members that has the exclusive right to elect that director may only be removed by an ordinary resolution of that class or group.

[110] Non-members and members of a corporation may be eligible to serve as directors, unless otherwise provided by the articles or by-laws.[111] Directors have the right to attend meetings, take part in discussions and, in general, make motions and vote. However, the articles or by-laws may provide for special categories of directors, who may or may not have voting rights, such as *ex officio* directors (i.e. directors appointed by virtue of holding a certain office or position), honorary directors (directors appointed to recognize long or distinguished service), and public directors (i.e. directors appointed to represent the public). *Ex officio*, honorary and public directors without voting rights can still attend meetings, take part in discussions and carry out other functions of directors.

[111] The problem with appointing *ex officio*, honorary and public directors without voting rights is that these special categories of directors are still treated as directors under the law. It should indeed be kept in mind that the right to vote is only one feature of directorship. Non-voting directors may participate in many activities that influence the stewardship of the corporation. Consequently, all directors, in that capacity, have statutory obligations and duties and can be found legally liable, regardless of whether or not they have voting rights. For instance, an *ex officio*, honorary or public director may be liable for unpaid wages under certain incorporation statutes.[112]

[112] To avoid this type of issue, the CNCA prohibits having *ex officio*, honorary or public directors and provides that directors must be elected by ordinary resolution of members at the annual general meeting.[113] However, the Act authorizes directors to appoint up to one-third of the board, if the articles of the corporation so provide.[114] This choice has been criticized as being at odds with the governance structure of many non-profit organizations. For example, commentators have pointed out that this prohibition does not sit well with corporations that have a structure which provides for a larger number of *ex officio*

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[111] The legislation or the governing documents of the corporation may set out qualification requirements for directors. For example, the by-laws may require a director to be a member of the corporation. See CNCA, s 26.

[112] For instance, section 146(1) of the CNCA which provides that "Directors of a corporation are jointly and severally, or solidarily, liable to employees of the corporation for all debts not exceeding six months' wages payable to each employee for services performed for the corporation while they are directors", does not distinguish between categories of directors; all directors, including *ex officio*, honourary and public directors, are thus potentially liable for unpaid wages.

[113] CNCA, s 128(3).

[114] CNCA, s 128(8).

directors, such as national umbrella organizations that have their board made up of representatives of regional chapters.

[113] The decision to provide for special categories of directors in the articles or by-laws should be left to the corporations. We do not think that the new act should expressly permit or prohibit *ex officio*, honorary or public directors.[115] However, the act should make a distinction between honorary directors, on one hand, and *ex officio* or public directors, on the other.

[114] Individuals who are named "director" for purely honorary purposes but who do not participate in the governance of the corporation should not be imposed with the duties and liabilities of a director solely for holding that title. Honorary directors who have none of the directors' powers should be expressly excluded from the definition of director under the act.[116]

[115] *Ex officio* and public directors who are appointed by virtue of holding a certain office or to represent the public are usually expected to play an active role on the board of the corporation. "*Ex officio* director" and "public director" are not purely honorary titles and should be included in the definition of director. It should be clear that individuals who are given directors' powers, including *ex officio* and public directors, have corresponding duties and liabilities. Corporations should be aware of the implications of appointing directors, especially non-voting directors, as such individuals may end up liable for board decisions without any real opportunity to oppose or register dissents.

RECOMMENDATION 16

The term "director" should be defined in the legislation to clarify with whom lie the duties and liabilities of directors. Individuals who are given the "director" title or designation for purely honourary purposes without any participation rights or obligations should be expressly excluded from that definition. The new act should not prohibit having *ex officio* or public directors. However, educational materials should make it clear that *ex officio* and public directors are directors and, in that capacity, subject to the duties and liabilities of directors.

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[115] The CNCA provides that directors are elected by members. As a result, *ex officio* directors are now prohibited.

[116] To alleviate the risk that honourary directors be held liable for board decisions in which they do not fully participate, organizations should find another title or designation that makes it clear that those individuals do not actively participate in the decision-making process of the corporation, such as honourary advisor or patron.

[116] One of the responsibilities of directors is to appoint officers to assist them with the management of corporate activities and affairs.[117] Directors can appoint officers to any offices of the corporation they want to fill. For more clarity, the term "officer" should be legislatively defined to mean any individual so appointed by the directors, including a chairperson of the board of directors, a president, a vice-president, a secretary, a treasurer, a comptroller, a general counsel, and a general manager or managing director.

[117] However, we think that the question of whether an individual who is not formally appointed but "performs functions for a corporation similar to those normally performed by an individual occupying any of those offices" may be deemed an officer should be left to the courts.[118] Given the fact that fiduciary duties generally extend not only to directors, but to officers as well, caution should be exercised before including in the definition of "officer" individuals who are not specifically appointed to an office of the corporation by the directors.[119]

RECOMMENDATION 17

The new act should define the term "officer" to include any individual appointed by the directors to one of the offices of the corporation. The definition should not extend to an individual who performs functions for a corporation similar to those normally performed by an individual occupying any of those offices without having been formally appointed to that office.

B. Duties of Directors and Officers

ISSUE 9

Should the legal duties of directors and officers be codified in the non-profit corporate legislation? If so, which ones? (Recommendations 18 to 21)

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[117] Officers are appointed at the first meeting of the directors; they are subsequently reappointed or replaced at the discretion of the directors.

[118] CNCA, s 2(1).

[119] The Supreme Court of Canada in *Canadian Aero* held that officers who act as "top management" and "not mere employees" are subject to the same fiduciary duties as directors: *Canadian Aero Service Ltd v O'Malley* (1973), [1974] SCR 592, at para 22. While it may not always be the case that officers in non-profit corporations act as "top management", the preferred approach seems to be that the fiduciary duty should nevertheless be extended by statute to all officers.

[118] As discussed above, the overall duty of the directors is to effectively manage or supervise the management of the activities and affairs of the corporation. The scope of the directors' powers is subject to the legislation, the articles of incorporation or the by-laws.[120] Directors must comply with all applicable statutes and regulations, as well as the corporation's governing documents.[121] Day-to-day management functions are generally delegated to officers who report to directors.[122] Because of the position of authority, trust and confidence that directors and officers hold in relation to the corporation and its members, the law imposes on them a number of duties and liabilities.[123]

[119] The fiduciary duties of directors and officers can be divided in two categories: (1) the duty of loyalty, and (2) the duty of care. Simply put, this means that directors and officers must act with honesty and good faith in the best interests of the corporation (duty of loyalty). They are also required to exercise the level of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (duty of care). No provision in a contract, a resolution, the articles of incorporation or the by-laws can relieve a director or officer from liability for breach of those fiduciary duties.[124]

[120] This does not mean that every decision of the directors or officers must be found in hindsight to be the ideal or perfect decision, or even the correct one. When reviewing the actions of the directors or officers, courts generally apply a test known as the "business judgment rule" to assess whether or not they have met their duties to the corporation. On that basis, they will defer to the business judgment of the directors or officers, provided that they have acted with an honest belief that the decision being taken was in the best interests of the corporation.[125] In other words, a court has to be satisfied that the directors or

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[120] Directors' powers may be fettered by unanimous agreements of the members of the corporation who then take on the liabilities associated with exercising those powers.

[121] Some corporate statutes – for-profit and non-profit – specifically codify the duty to comply: see, for example, CNCA, s 148(2).

[122] Certain powers cannot be delegated to officers, such as the approval of financial statements, or the decision to adopt, amend or repeal corporate by-laws. See, for example, CNCA, ss 138 and 142.

[123] Directors and officers are described as "fiduciaries" of the corporation they serve because they have the discretionary power to affect another party (the corporation's) legal or practical interest: *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 37. See also *Galambos v Perez*, 2009 SCC 48.

[124] See, for example, CNCA, s 148(4). See also *Re Unique Broadband Systems Inc,* 2014 ONCA 538 at para 72.

[125] *Peoples Department Stores Inc (Trustee of) v Wise,* 2004 SCC 68 at para 67. In *Re Unique Broadband Systems Inc,* 2014 ONCA 538 at para 72, the Ontario Court of Appeal stated that:

> It must be remembered that the business judgment rule is really just a rebuttable presumption that directors or officers act on an informed basis, in good faith, and in the best interests of the corporation. Courts will defer to business decisions honestly made, but they will not sit idly by when it is clear that a

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officers arrived at a reasonable decision after taking steps to inform themselves sufficiently, obtaining independent advice from experts if needed.

[121] Fiduciary duties of directors and officers have been developed at common law. However, most for-profit corporate legislation and more recent non-profit corporate legislation include provisions partly codifying these fiduciary duties. While stated in general terms, such provisions nevertheless have the advantage of articulating criteria by which to review directors' and officers' conduct. There are no provisions in either the *Societies Act* or the *Companies Act* that set out directors' and officers' fiduciary relationship to the corporation.

RECOMMENDATION 18

The new act should state that all directors and officers owe fiduciary duties to the corporation; it should be clear that fiduciary duties include both a duty of loyalty and a duty of care. Accompanying materials should explain what those fiduciary duties are.

1. DUTY OF LOYALTY

[122] The duty of loyalty is defined as the obligation of a director or officer "to act honestly and in good faith with a view to the best interests of the corporation" when exercising their powers and discretion.[126] The duty of loyalty encompasses several requirements such as:

- not using their powers for an improper motive,
- not abusing their positions for personal benefit,
- avoiding conflicts of interest, except with the corporation's knowledge and consent, and
- maintaining and protecting the confidentiality of corporate information.

[123] Among other implications, this means that directors and officers cannot make incomplete or misleading representations in their dealings with the corporation, be driven by self-interest, take any action intended to deprive the

board is engaged in conduct that has no legitimate business purpose and that is in breach of its fiduciary duties.

[126] See CNCA, s 148(1)(a); Saskatchewan Act, s 109(1)(a).

corporation of some asset or benefit to which the corporation is entitled, or give an undue preference or advantage to or discriminate against an interested party.[127] For instance, directors may not use their power to admit only members sympathetic to them or to expel members who are not.

[124] As noted, directors and officers are required to act in the best interests of the corporation, and to subordinate any other interests to the extent they conflict with those of the corporation.[128] As Granger J. stated in *Moffatt v. Wetstein*: [129]

> Subsumed in the fiduciary's duties of good faith and loyalty is the duty to avoid a conflict of interest. The fiduciary must not only avoid a direct conflict of interest but must also avoid the appearance of a possible or potential conflict. The fiduciary is barred from dividing loyalties between competing interests, including self-interest.

[125] Directors and officers are obligated to avoid both actual conflicts of interest and potential conflicts of interest. Conflicts of interest can be self-interest conflicts, that is, conflicts between a director's or officer's duties to the corporation and their own personal interests, or dual loyalties conflicts, that is, conflicts between a director's or officer's duties to the corporation and the duties owed to another person or organization. In addition, inherent in the duty of loyalty is an obligation for directors and officers to maintain and protect the confidentiality of corporate information acquired in that capacity, and the obligation not to use this information to their own advantage.

[126] While the avoidance of conflicts of interest falls within the basic fiduciary duties of directors and officers, this does not answer the practical question of what to do when a conflict of interest arises. Some statutes acknowledge that conflicts of interest will arise from time to time and include procedural provisions to deal with these situations. These provisions typically set out procedures to follow regarding disclosure, participation in debate, vote abstention and other conditions that can protect the validity of a contract or

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[127] *Peoples Department Stores Inc (Trustee of) v Wise,* 2004 SCC 68 at paras 35 and 42; *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 39.

[128] Although the duty of loyalty is owed primarily to the corporation as such, it is nonetheless legitimate for directors and officers to take into consideration the interests of the corporation's members, employees, beneficiaries, creditors, and other stakeholders in determining what may be in the best interests of the corporation: *Peoples Department Stores Inc (Trustee of) v Wise,* 2004 SCC 68; *BCE Inc v 1976 Debentureholders*, 2008 SCC 69. See also *Hadjor v Homes First Society*, 2010 ONSC 1589; *Re London Humane Society,* 2010 ONSC 5775; *Ontario Society for the Prevention of Cruelty to Animals v Toronto Humane Society*, 2010 ONSC 1953.

[129] *Moffatt v Wetstein* (1996), 29 OR (3d) 371 at 390 (Gen Div).

transaction.[130] Because it is not uncommon for directors and officers of non-profit corporations to serve as directors, officers or staff of another corporation, or to be elected or appointed to the board to represent the interests of particular stakeholders, we think that special consideration should also be given to the issue of conflict of loyalty.

RECOMMENDATION 19

The new act should include a conflict of interest provision for directors and officers. Specific procedural rules should also be set out to deal with "conflict of loyalty" or "dual loyalty" issues. Educational materials should clarify that the phrase "conflict of interest" in the non-profit context includes more than a material conflict interest and extends to conflict of loyalty.

2. DUTY OF CARE

[127] The duty of care is defined as the obligation of a director or officer "to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances" in carrying out their functions.[131] The duty of care includes responsibilities such as:

- overseeing all aspects of the corporation's operations,
- attending meetings whenever possible,[132]
- educating themselves about the corporation's purpose, articles of incorporation, by-laws, internal policies, activities and financial affairs,[133]

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[130] For example, s 107 of the Saskatchewan Act requires a director or officer of a non-profit corporation to disclose in writing (or to have entered into the minutes) a contract or proposed contract in which he or she has a material interest. No director with a conflict of interest may vote on a resolution to approve the contract unless certain conditions are met. As recently reaffirmed by the Ontario Court of Appeal, disclosure of a director's or officer's personal interest is required as a first step, but it does not relieve the director or officer of their obligation to act honestly and in the best interests of the corporation: *Re Unique Broadband Systems Inc*, 2014 ONCA 538. See also *UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc* (2002), 214 DLR (4th) 496 (Ont SC), aff'd (2004), 250 DLR (4th) 526 (Ont CA).

[131] See CNCA, s 148(1)(b); Saskatchewan Act, s 109(1)(b).

[132] Directors are not legally required to attend board meetings. However, consistent failure to attend meeting would likely be considered a breach of their duty of diligence. Generally, directors cannot vote or participate in meetings by proxy. The duty of diligence extends to reviewing the minutes when a meeting must be missed.

[133] CNCA, s 148(2) expressly provides that:

> **Duty to comply**
>
> **148(2)** Every director and officer of a corporation shall comply with

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- becoming or remaining informed regarding the decisions the board has to make and any other issues that may affect the corporation,
- obtaining professional advice when necessary, and
- not to improperly delegate their powers.

[128] Directors and officers must pay attention to the management of the corporation's affairs. Although important, simply attending meetings is not sufficient to meet the duty to act with care, skill and diligence. Directors and officers are also required to demonstrate an appropriate degree of knowledge and competence when managing or supervising the management of the corporation, which includes being ready to make informed decisions affecting the corporation and ensuring the lawfulness of their actions.[134]

[129] The duty of care must be performed to a certain standard (standard of care). Because there are currently no provisions in either the *Societies Act* or the *Companies Act* defining what that standard of care is, non-profit corporations' directors and officers are held to a common law standard that varies depending on the directors' and officer's particular abilities.[135] The subjective standard asks: what level of care, diligence and skill should a director or officer have exercised in the circumstances considering his or her particular knowledge and experience?[136] This means, for example, that a director with financial training might be held to a higher standard than another director with no such background.[137]

[130] In contrast, under an objective standard of care, the decisions and actions of the directors or officers are assessed against the same benchmark. The objective standard asks: what level of care, diligence and skill would a

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(a) this Act and the regulations; and

(b) the articles, the by-laws and any unanimous member agreement.

[134] CNCA, s 148(3) expressly provides that: "Every director of a corporation shall verify the lawfulness of the articles and the purpose of the corporation".

[135] The absence of statutory provisions clearly articulating the duty owed and the standard of care required is reportedly a disincentive for persons to serve as directors and officers of non-profit corporations. See, for example, Saskatchewan Report at 18.

[136] Terrance S Carter, "The Legal Duties of Directors and Officers of Charities and Not-for-Profits (Alberta)" (Presentation delivered at the Wild Rose Foundation – Vitalize 2007, 8 June 2007), available online at <www.carters.ca/pub/seminar/charity/2007/tsc0608a.pdf> [Carter].

[137] This subjective standard is also reportedly a barrier to the recruiting, training and retention of qualified individuals. Industry Canada Corporate and Insolvency Law Policy Directorate Policy Sector, *Reform of the Canada Corporations Act: Discussion Issues for a New Not-for-Profit Corporations Act*, March 2002 at 15, available online at: <www.ic.gc.ca/eic/site/clip-pdci.nsf/vwapj/optionfinal_en_ed.pdf/$FILE/optionfinal_en_ed.pdf>.

reasonably prudent person have exercised under comparable circumstances? This means that all directors or officers are held to the same standard of care when determining whether they have breached their duty to the corporation, regardless of their background or experience.

[131] Most for-profit corporate statutes – and some non-profit corporate statutes – clearly articulate the directors' and officers' duty to act with the level of care, skill and diligence that a reasonably prudent person would exercise in comparable circumstances. Such provisions set out an objective standard by which to judge directors and officers. In meeting their duty of care, directors and officers may rely in good faith on written advice or reports prepared by professionals.[138] However, they are still required to give proper oversight to their advisor. Directors (but not officers) may also rely on the corporation's financial statements prepared by a public accountant.

[132] We think that an objective standard of care provides better guidance with respect to what is expected from directors and officers, and should be included in non-profit corporate legislation.[139] The act should define the standard of care as that of a reasonable person under the same circumstances without regard to that director's or officer's particular knowledge or experience. The act should also make it clear that reliance in good faith on professional advice should be one of the factors taken into account when determining whether a director or officer has satisfied the objective standard of care.

RECOMMENDATION 20

The new act should provide an objective standard of care for both directors and officers; the objective standard should be that of a reasonably prudent person in similar circumstances.

3. OTHER DUTIES

[133] The corporate duties of directors and officers have been variously described.[140] Some of these duties are subsumed in the legal obligations

[138] Directors and officers should still, however, give proper oversight to their outside advisors and not rely unquestioningly on their professional advice. *See UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc* (2002), 214 DLR (4th) 496 (Ont SC), aff'd (2004) 250 DLR (4th) 526 (Ont CA).

[139] It should be noted that a subjective standard of care applies to directors and officers, unless the incorporating statute sets out a different standard.

[140] The Saskatchewan Report describes them as diligence, prudence and loyalty. Carter, note 136 at 5-6 describes them as the duties to act honestly, duty of loyalty, duty of diligence, duty to exercise power, duty of obedience, duty to avoid conflict of interest, duty of prudence, and duty to continue.

described above, while others may have a slightly broader span of responsibility. The question is whether there are any other areas where it may be helpful to directors and officers to have an express formulation of their duties? Possible areas of codification include:

- duty to manage or supervise the management, that is, the duty to oversee the activities and affairs of the corporations, and not to delegate their responsibilities, except under certain circumstances and with adequate supervision,[141]
- duty of fidelity or obedience, that is, the duty to act in accordance with the stated purposes,[142]
- duty to comply, that is, the duty to comply with the incorporating statute, the regulations, the articles or the by-laws, and[143]
- duty to continue, that is, the liability of former directors for actions or decisions taken up to the date of their resignation.[144]

[134] We think that the core components of these other corporate duties are generally encompassed in the duty of loyalty and the duty of care, and do not need to be independently codified. The specific content of these duties may be best elaborated elsewhere, for example, in a code of conduct. In the case of the duty to comply, however, it may be preferable to expressly state that directors and officers are required to act within the law because of the greater liability exposure associated with acting beyond the scope of their authority.[145]

RECOMMENDATION 21

The new act should expressly state that directors and officers are required to comply with the incorporating statute, the regulations, the articles of incorporation and the by-laws.

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[141] See CNCA, ss 124, 138(2) and 142(1).

[142] The duty of fidelity may be broader than following the stated purposes. The statute may however provide that the duty is owed to the members, and only internally enforceable (this issue is discussed in the *Purposes* section above); this is closely related to the duty to members. The duty to members is defined as the duty to abide by the terms of the articles of incorporation, which include the corporation's purpose, and the by-laws. Although fiduciary duties are owned to the corporation and not the members, the corporation's articles and by-laws have been considered akin to a contract between the corporation and its members.

[143] See, for example, CNCA, s 148(2).

[144] See, for example, CNCA, s 145(5).

[145] Directors and officers are only protected from liability when they are acting in accordance with the incorporating statute and governing documents. When directors and officers act beyond the scope of the authority granted to them, they may be found personally liable.

C. Liabilities of Directors and Officers

ISSUE 10

What protection from personal liability should be made available to directors and officers? (Recommendations 22 to 25)

[135] As a distinct legal entity, a corporation has a separate legal personality from its directors, members and other stakeholders. A corporation can own property, enter into contracts, be vicariously responsible for the civil wrongs of its employees, as well as sue and be sued in the courts. Generally, directors and officers of corporations, like other members, are not personally responsible for the actions or omissions of the corporation they serve. There are, however, rare exceptions. In some cases – which are entirely context-driven – Canadian law has disregarded the separate legal personality of a corporation to hold a director or officer responsible for decisions he or she has made as a director or officer of that corporation.[146]

[136] Finding directors and officers personally liable is the exception, not the rule, and even more so in the non-profit context. Personal liability is a fairly blunt instrument, especially when one considers the typical profile of a board member of a non-profit corporation. As the Law Reform Commission of Saskatchewan observed:[147]

> The liability of board members of not-for-profit corporations is almost identical to the liability of directors and officers of business corporations. But unlike a director or officer of a business corporation, a board member in the not-for-profit sector is usually an unpaid volunteer, who can devote only limited time and attention to his or her duties. While board members bring a variety of experience to the organization, many lack business or managerial experience. It is often difficult for volunteer board members to identify the risks that might lead to personal liability.

[137] Accordingly, both in the for-profit and in the non-profit sectors, legislative mechanisms have been introduced to help guard against potential liability. The range of possible mechanisms is discussed below. The key issue is how to find the right balance such that a "bad actor" is not protected, but a board member who acts conscientiously is provided with some measure of security.

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[146] Carter, note 136.

[147] Saskatchewan Report at 7.

1. DISSENT

[138] Directors are both individually and jointly and severally liable for the management of a corporation.[148] For example, section 145(1) of the CNCA provides that:

> **145.(1)** Directors of a corporation *who vote for or consent to a resolution* authorizing any of the following are jointly and severally, or solidarily, liable to restore to the corporation any money or other property so paid or distributed and not otherwise recovered by the corporation [emphasis added]:
>
> (a) a payment or distribution to a member, a director or an officer contrary to this Act; or
>
> (b) a payment of an indemnity contrary to this Act.

[139] Under the CNCA, directors are deemed to have consented to any resolution passed or action taken at the meeting, whether or not they were present at a meeting of directors or of a committee of directors.[149] Pursuant to section 145(1), those directors may thus be jointly and severally liable for restoring to the corporation any money or property if payment or distribution was made in contravention of the Act. However, a director may escape potential liability for a decision he or she disagreed with by formally registering his or her dissent. Only by taking some positive action as set out in the CNCA can a director be seen to have dissented.

[140] The CNCA's dissent procedure is as follows. A director who is present at a meeting of directors or of a committee of directors may request a dissent to be entered in the minutes of the meeting, send a written dissent to the secretary of the meeting before the meeting is adjourned, or send a dissent by registered mail

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[148] Carter, note 136, at 3.

[149] Under s 147(3) of the CNCA, directors are deemed to have consented to a resolution passed or an action taken at a meeting, *whether or not they were present at the meeting*, unless they formally dissent. The key reason for this policy choice is that it is the duty of the directors to oversee the operations of the corporation, keep informed about any decisions the board has to make, exercise independent judgment in all corporate decisions, and stay abreast of the board's activities. This includes, for example, voicing their concerns if they think a resolution or action of the board may be contrary to law. Not being able to attend a meeting does not relieve absentees of their duty as directors of the corporation. Deeming directors to have consented to a resolution passed or action taken at a meeting unless they dissent gives them an additional incentive to challenge questionable board decisions; the fact that a director takes positive steps to dissent from a resolution or action may also cause other directors to rethink their position. It should be noted, however, that under section 123 of the BCA, only directors who were present at a meeting are deemed to have consented to any resolution passed or action taken at the meeting. Therefore, directors who were not present at a meeting need not use the dissent procedure as they are not deemed to have consented to any resolution passed or action taken at the meeting.

or deliver it to the registered office of the corporation immediately after the meeting is adjourned.[150] A director who votes for or consents to a resolution is no longer entitled to dissent under this procedure.[151] Within the prescribed period after becoming aware of the resolution or action, a director who was not present at a meeting at which a resolution was passed or action taken may cause a dissent to be placed with the minutes of the meeting, or send a dissent by registered mail or deliver it to the registered office of the corporation.[152]

[141] The application of such dissent procedure is limited. It only protects directors from being held liable for decisions of the board if they disagreed on record to resolutions passed or actions taken at a meeting. Moreover, the dissent procedure does not offer protection when the question of whether a director has voted or consented, or is deemed to have consented, to a resolution or action is irrelevant.[153]

[142] Neither the *Societies Act* nor the *Companies Act* contains any dissent procedure. Some more recent non-profit legislation, however, has included such a provision.[154] The question is whether the inclusion of a dissent provision in the new legislation may be of any real benefit for the sector.

[143] The principal shortcoming of a dissent procedure is that it does not protect a director or officer from liability for decisions that did not come before the board, nor for liability from omissions where the board did not put in place

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[150] CNCA, s 147(1).

[151] CNCA, s 147(2).

[152] CNCA, s 147(3).

[153] For example, dissenting directors may not be able to escape liability under section 146(1) of the CNCA which provides that "*directors of a corporation* are jointly and severally, or solidarily, liable to employees of the corporation for all debts not exceeding six months' wages payable to each employee for services performed for the corporation while they are directors"[emphasis added]; this provision refers to "directors of a corporation", not just "directors of a corporation who vote for or consent to a resolution".

[154] For example, s 110 of the Saskatchewan Act provides:

> **110(1)** A director who is present at a meeting of directors or committee of directors is deemed to have consented to any resolution passed or action taken at that meeting unless he or she:
>
> (a) requests that his or her dissent be entered in the minutes of the meeting;
>
> (b) sends a written dissent to the secretary of the meeting before the meeting is adjourned; or
>
> (c) sends a dissent by registered or certified mail or delivers it to the registered office of the corporation immediately after the meeting is adjourned.
>
> **(2)** A director who votes for or consents to a resolution is not entitled to dissent pursuant to subsection (1).
>
> **(3)** A director who was not present at a meeting at which a resolution was passed or action taken is deemed to have consented to the resolution unless, within seven days of becoming aware of the resolution, he or she:
>
> (a) causes his or her dissent to be placed with the minutes of the meeting; or
>
> (b) sends dissent by registered or certified mail or delivers it to the registered office of the corporation.

adequate oversight. Nonetheless, we think that a dissent procedure is an essential component of the directors' obligation to exercise independent judgment when voting. Directors who were present at a meeting but failed to formally indicate their dissent should not be able to change their mind later.[155] However, directors who missed a meeting should also be given the opportunity to record a dissent within the prescribed period.

RECOMMENDATION 22

The new act should set out a dissent procedure for directors who were present at a meeting, and a procedure for directors who were not present at a meeting. Directors not present at a meeting should have seven days from the date they become aware of the resolution or action to formally indicate their dissent.

2. DUE DILIGENCE DEFENCE

[144] Directors and officers are responsible for breaches of their duties to the corporation, including the duty of loyalty and the duty of care. Moreover, provincial and federal legislation, including incorporation statutes, sometimes impose additional obligations on directors and officers.[156] Examples of specific statutory liabilities include:[157]

- liability for improper payments to members, directors and officers,
- liability for employee wages,
- liability for contraventions to the act or regulations,
- liability for false or misleading statements,

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[155] BCLI Consultation at 63.

[156] While liabilities of directors and officers are generally set out in corporate legislation, a growing number of federal and provincial statutes also prescribe specific liabilities. Examples of statutes providing for personal liability of directors and officers include: failing to contribute to an employee pension plan and other related labour statues: *Employment Pension Plans Act*, SA 2012, c E-8.1; *Workers Compensation Act*, RSA 2000, c W-15; *Health Insurance Premiums Act*, RSA 2000, c H-6; *Occupational Health and Safety Act*, RSA 2000, c O-2. They may also be personally liable where the corporation has not complied with environmental protection and enhancement procedures: *Environmental Protection and Enhancement Act*, RSA 2000, c E-12. In addition, they may be found personally liable under human rights or trust legislation: *Alberta Human Rights Act*, RSA 2000, c A-25.5. Under the *Income Tax Act*, RSC 1985, c 1 (5th Supp), directors are also responsible for any employee income tax deductions that the corporation fails to remit for a period of two years after they cease to be directors.

[157] See CNCA, ss 145, 146, 148, 232 and 262.

- liability for misuse of membership information, and
- liability during liquidation and dissolution.

[145] Generally, legislation providing that directors and officers may be held personally liable for their actions or omissions also sets out a due (or reasonable) diligence defence.[158] "Due diligence" means a director or officer has met the standard of the duty of care discussed in the preceding section of this Report, or, in other words, has exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. A due diligence defence means that it is up to the director or officer to prove that he or she met the standard in carrying out the duties of director or officer.

[146] Neither the *Societies Act* nor the *Companies Act* includes a due diligence defence. More recent Canadian non-profit corporate legislation, however, has included such a provision in order to clarify that this defence (which is part of the common law) is available to directors and officers of non-profit corporations. The statutory formulation usually also makes it clear that a director or officer is excused from liability where they have reasonably relied on professionals.[159]

[147] Because of their position of authority, trust and confidence in the corporation, directors and officers may bear a degree of financial responsibility for their decisions. As previously mentioned, however, provisions holding directors and officers personally liable are exceptions to the principle that those individuals are not held responsible for the actions or omissions of the corporation they serve. As such, these provisions should be limited in their application. For that reason, provisions that impose personal liabilities on directors and officers should generally allow a due diligence defence for directors and officers who relied in good faith on financial statements provided to them by an officer or auditor of the corporation, or on the opinions, conclusions or recommendations of professionals made to the corporation.

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[158] See CNCA, ss 149(1), 150(1), 232(2) and 262(5).

[159] For example, s 149(1) of the CNCA provides:

> **149(1)** A director is not liable under section 145 or 146, and has complied with his or her duties under subsection 148(2) and (3), if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on
>
> (a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the public accountant of the corporation fairly to reflect the financial condition of the corporation; or
>
> (b) a report of a person whose profession lends credibility to a statement made by that person.

RECOMMENDATION 23

The new act should include a due diligence defence for directors and officers who relied on written professional advice, opinions or reports in making their decisions. The term "professional" should be defined broadly to include any person whose profession lends credibility to a statement made by that person.

3. IMMUNITY OR RELIEF FROM CIVIL LIABILITY

[148] The "corporate veil" that typically protects directors and officers from personal liability may on occasion be pierced. Generally, a court will only disregard the separate legal personality of a corporation where it finds that the directors or officers used the corporation as a shield to commit fraudulent or other improper conduct, or expressly directed that wrongful things be done.[160]

[149] Directors and officers can also be found personally liable in tort or in contract.[161] However, a director or officer acting in good faith within the scope of his or her authority will not be personally liable unless it can be proven, for example, that the director or officer acted in his or her own interest or another's interest, rather than in the best interest of the corporation. Situations where courts may be willing to pierce the corporate veil are exceptional:[162]

> Those cases in which the corporate veil has been pierced usually involve transactions where the use of the corporate structure was a sham from the outset or was an afterthought to a deal which had gone sour. There is also a considerable body of case law wherein injured parties to actions for breach of contract have attempted to extend liability to the principals of the company by pleading that the principals were privy to the tort of inducing breach of contract between the company and the plaintiff: see *Ontario Store Fixtures Inc. v. Mmmuffins Inc*. (1989), 70 O.R. (2d) 42, 16 A.C.W.S. (3d) 426 (H.J.C.), and the cases referred to therein. Additionally there have been attempts by injured parties to attach liability to the principals of failed businesses through insolvency litigation. In every case, however, the facts giving rise to personal liability were specifically pleaded. Absent allegations which fit within the categories described above, officers or employees of limited companies are protected from

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[160] See, for example, *Montreal Trust Co of Canada v ScotiaMcLeod Inc* (1995), 26 OR (3d) 481 (Ont CA); *Brae Centre Ltd v 1044807 Alberta Ltd*, 2008 ABCA 397; *Petrobank Energy & Resources Ltd v Safety Boss Ltd*, 2012 ABQB 161; *GC Capital Inc v Condominium Corp No 0614475*, 2013 ABQB 300; *Hogarth v Rocky Mountain Slate Inc*, 2013 ABCA 57; *Resource Well Completion Technologies Inc v Canuck Completion Ltd*, 2014 ABQB 209.

[161] A full elaboration of these areas is beyond the scope of this document. See Carter, note 136.

[162] *ADGA Systems International Ltd v Valcom Ltd* (1999), 43 OR (3d) 101 at para 38 (CA).

> personal liability unless it can be shown that their actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own.

[150] Although extremely remote, personal liability is a possibility for all directors and officers, including those who volunteer with non-profit corporations. Thus, non-profit corporate legislation sometimes provides for immunity from civil liability for directors and officers. For example, the Saskatchewan Act states that: "Unless another act expressly provides otherwise, no director or officer of a corporation is liable in a civil action for any loss suffered by any person".[163] The availability of the immunity is subject to the director or officer acting in good faith and does not apply to fraudulent or criminal misconduct or to criminal or quasi-criminal offences.[164]

[151] Nova Scotia's *Volunteer Protection Act* goes even further. Section 3 provides immunity for all volunteers, provided certain conditions are met.[165] The definition of "volunteer" would include directors and officers provided they are not paid in excess of $500 per year, excluding reasonable reimbursement or allowance for expenses actually incurred.

[152] In contrast, neither the *Societies Act* nor the *Companies Act* provides directors or officers with any limit on or relief from personal liability. Similarly, most Canadian non-profit corporate statutes do not contain provisions limiting personal liability for directors or officers. For example, neither the CNCA nor the ONCA contains such a provision.

[153] For those jurisdictions that have opted to limit the civil liability of directors and officers, the rationale is that, although there are exceptions, the vast majority of board members are motivated by the desire to make a contribution to their community. This commitment translates into an incentive to serve the organization and protect the public.[166]

[154] As an alternative, some have recommended that, rather than a provision granting non-profit director or officer immunity from personal liability, the courts should have the power to provide relief from liability where a director or

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[163] Saskatchewan Act, s 112.1. The Act expressly provides that the limitation on directors' and officers' liability does not affect the liability of the corporation for loss suffered.

[164] Saskatchewan Act, s 112.1(4).

[165] *Volunteer Protection Act*, SNS 2002, c 14, s 3.

[166] Saskatchewan Report at 17.

officer acted honestly and reasonably and ought fairly to be excused.[167] Court discretion also ensures that directors and officers who acted in a questionable manner still remain accountable for their actions or omissions. This type of provision is typically found in trustee legislation.[168]

[155] Though it is clear from the case law that disregarding the separate legal personality of a corporate entity is the exception rather than the rule, the possibility of being held personally liable as director or officer of a corporation may nevertheless be a concern – if not a deterrent – for people who serve on the boards of non-profit corporations. Expressly giving courts the power to relieve directors and officers from personal liability on a case-by-case basis may bring some reassurance to those concerned about the scope of their liability. Furthermore, it essentially codifies an otherwise complex legal issue in a way that is consistent with the case law (i.e. courts have in general answered negatively to the question of whether a director or officer who acted in good faith within the scope of his or her authority should be held personally liable for a decision made by the board).

RECOMMENDATION 24

The new act should provide that courts have the power to relieve directors and officers from personal liability where they acted in good faith and within the authority granted by the incorporating statute and governing documents.

4. INDEMNIFICATION AND LIABILITY INSURANCE

[156] Given the potential for liability, the availability of indemnification and insurance for directors and officers of non-profit corporations is an important consideration. Currently, neither the *Societies Act* nor the *Companies Act* addresses these matters.

[157] The trend in modern non-profit corporate legislation is to include provisions that permit a corporation to indemnify and/or purchase insurance for their directors and officers, provided certain conditions are met. For example, the Saskatchewan Act permits a non-profit corporation to indemnify their directors and officers for costs, charges and expenses incurred in a court action resulting from any act made or permitted by them in the execution of their duties,

[167] BCLI Consultation at 59-60; ALRI Report 49 at 53.

[168] See, for example, *Trustee Act*, RSA 2000, c T-8, s 41.

provided they acted honestly and in good faith with a view to the best interests of the corporation. An additional condition is usually added in the case of a criminal or administrative action or proceeding enforced by a monetary penalty, such as the director or officer must have had reasonable grounds to believe their conduct was lawful.[169]

[158] The inclusion of an indemnity provision raises a number of considerations. Should it be available to both directors and officers? Should it be at the discretion of the corporation or mandatory? What conditions must be met before it is available? What costs would it cover? The main practical limitation of an indemnity provision is that any lawsuit resulting from a director's alleged misconduct is likely to be brought against both the non-profit corporation and the director. Where the lawsuit is successful, a non-profit corporation may lack the financial resources to honour its indemnification provision. For that reason, we think that the legislation should make it clear that a corporation has the power to indemnify its directors and officers, but the decision to provide such indemnity should be left to the corporation.[170]

[159] The availability of insurance for direct liability of directors and officers may complement an indemnification provision and help to supplement the financial resources available to a non-profit corporation.[171] The advantage of a non-profit corporation purchasing directors and officers insurance is that it protects itself from the potential financial responsibility for large claims if its directors and/or officers are sued successfully. Many non-profit corporations lack the resources to cover the cost of a substantial judgment against its directors and officers. [172] The disadvantages are that such insurance may be costly to purchase and may contain significant exclusions from coverage. Here again, we think that it should be up to each corporation to choose whether or not to purchase insurance for its directors and officers.

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[169] See, for example, Saskatchewan Act, s 111(1) and (4).

[170] Any details relating to the indemnification of directors and officers (e.g. range and extent of coverage, conditions of admissibility or other restrictions) should be set out in the by-laws of the corporation.

[171] For example, s 111(5) of the Saskatchewan Act provides that:

> **111(5)** A corporation may purchase and maintain insurance for the benefit of an individual mentioned in subsection (1) against any liability incurred by the individual in the individual's capacity:
>
> (a) as a director or officer of the corporation; or
>
> (b) as a director or officer of another entity, or in a similar capacity, if the individual acts or acted in that capacity at the corporation's request.

[172] Saskatchewan Report at 26.

RECOMMENDATION 25

The new act should provide that a corporation may purchase liability insurance and/or indemnify its directors and officers who act in good faith, without making it a mandatory requirement.

CHAPTER 4

Members' Roles and Rights

[160] Like shareholders, members are those who get together to create the corporation or later join it. Unlike shareholders, however, members do not enrol with the expectation of making money, but because of the common interests, beliefs or occupations they share. Even members who put money in a non-profit corporation usually do so for the privilege of using its facilities or services, or to support its operations through low- or no-interest loans, not to realize a profit.

[161] Members collectively have a role to play in the stewardship of the corporation and this confers rights. Recent initiatives in non-profit corporate legislation propose to give members the equivalent of shareholders' rights in order to enhance democratic governance. For example, the CNCA and the ONCA (not yet in force) give members voting rights comparable with those of ordinary shareholders under for-profit corporate statutes. This proposition seems flawed in at least two ways.

[162] First, it gives little consideration to the fact that becoming a member is not typically a financial but, rather, a personal commitment to the non-profit corporation. As mentioned, unlike shareholders, most members have not made a capital investment and, therefore, have no ownership interest in the assets of the corporation to protect.

[163] Second, it goes further by equating members with common or ordinary shareholders who are entitled to a share of profit, a share of equity and a share of control as owners of the corporation. Members of a non-profit corporation do not need to have all the rights of ordinary shareholders, but they need the means to ensure that the corporation adheres to its purpose or consults them should there be any changes in that purpose.

[164] While the CNCA and the ONCA may go too far in conferring on members such a wide range of rights, the *Societies Act*, on the other hand, provides no guidance at all in this regard. The current Alberta legislation contains very few provisions concerning member rights and remedies. It is anticipated that the topic will be dealt with, if at all, in the by-laws.

[165] Non-profit corporate legislation should aim to strike an appropriate balance between the directors' and officers' duty to manage the corporation and the members' right to ensure that the corporation stays true to its purpose, and uses its resources to further that purpose. It should also recognize functional

differences within the non-profit sector, and enable corporations to tailor their governance structures to meet their needs and circumstances.

A. Members

ISSUE 11

Should non-profit corporate legislation include a definition of "member"? Should mandatory rules with respect to membership be included? (Recommendation 26)

[166] Many non-profit organizations are geared toward public benefit, and use membership as a way to designate program beneficiaries, recruit volunteers, enlist donors, or otherwise affiliate individuals or bodies. For example, museums, where the members' participation in governance is marginal or non-existent, generally have a looser membership base which serves, in essence, as an affiliation mechanism.

[167] Some organizations are member-focused and, therefore, structured to enhance member participation, both as patrons and overseers. "Member-focused" encompasses a wide range of organizations: from minor sport leagues, where members pay a small fee to play on a team, all the way to private clubs, where members make a significant investment in equity, initiation fees and annual dues for exclusive access and ownership stake.[173] While organizations like minor sport leagues typically use membership as a simple enrollment platform, others like private clubs usually have a governance structure specifically dedicated to a well-defined membership.

[168] Memberships are issued by the board in accordance with the conditions for determining who is eligible to be a member of the corporation.[174] The corporation's articles may provide for more than one category or class of membership, in which case the by-laws should set out the conditions for each particular category and class of membership described in the articles. Conditions for membership can be rather restrictive, for example, any directors of the corporation, or very broad, for example, any person who donates to the corporation.

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[173] Organizations in the latter group (e.g. golf clubs) are generally incorporated under Part 9 of the *Companies Act*.

[174] Under both the CNCA and ONCA, it is now mandatory to set out the conditions of membership in the corporation's by-laws (or articles). If there is more than one class of members, the membership conditions, voting rights, restrictions, privileges and period of membership must be set out for each class. At least one class of members must have the right to vote. See CNCA, s 154; ONCA, s 48.

[169] However, problems may arise when a corporation defines the range of its membership too broadly, or otherwise fails to properly address the issue. Fights over who is a member and who is not may easily cripple a corporation. Not distinguishing between members and other stakeholders may also cause some very practical and difficult issues, such as the costs and time required to send the annual financial statements or the required notices of meeting and all relevant documents to members who do not wish to receive them. In addition, a broader membership base may also raise issues related to quorum and resolution requirements, especially where a portion of the members are not interested in exercising their voting rights.[175]

[170] Non-profit legislation rarely defines what a member is. At best, it sometimes provides that a member is anyone designated by the board of directors.[176] The reason is probably that there is a degree of subjectivity to the definition of member. The lack of guidance is nonetheless problematic considering the importance for a corporation to define the range of its membership and the potential consequences that it may have on its operations.

[171] How a corporation defines its membership should reflect the roles members are expected to play in the corporation and the type of responsibilities involved. Each corporation should have the ability – maybe even the obligation – to define what a member is, and what entitlement membership confers in terms of participation in the corporation's governance. Although it should ultimately be up to each corporation to decide whether to limit its membership to those who want to play an active role in its operations, or extend it to everyone who makes a donation, or receives goods, services or other benefits from the organization, measures should be taken to ensure that this decision is informed and deliberate.

[172] To this end, the act should at a minimum provide that members are those who: (1) have been approved for membership through a process defined in the by-laws, and (2) are registered on a list of members by the prescribed date.[177]

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[175] For instance, passing member resolutions may become a problem when the incorporating statute or governing documents require the approval by a simple majority or two-thirds of the votes of the members *entitled* to vote at the meeting where an issue is discussed, and not just *present* at the meeting.

[176] The *Companies Act*, s 1(l) defines "member" as "a subscriber of the memorandum of a company and every other person who agrees to become a member of a company and whose name is entered in its register of members".

[177] A corporation should be able to put in a "cut-off" date by which a person has to join an organization in order to participate in general or special meetings of the members. To address the problem of "super-loading" the membership to manipulate the vote, there should be a rule stating that a person is not member unless they are on a list of registered members by the prescribed date. This requirement would also serve

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While it may also be good practice to reserve membership to those who take positive steps to signify their intention to participate in the corporation, we do not think that such requirement, that is, prospective member consent, should be included in a legislative definition of "member". Educational materials should, however, stress the pitfalls of an overly-broad or ill-defined membership and encourage corporations to carefully consider this issue when adopting by-laws.

RECOMMENDATION 26

The new act should require corporations to set out the conditions for membership, which at a minimum must include the process for admitting members and registering them on a list of members. The act should also provide that corporation must maintain an up-to-date list of members.

B. Roles of Members

ISSUE 12

What roles should members play in the stewardship of non-profit corporations? What are the responsibilities of the members? (Recommendation 27)

[173] Non-profit corporations, unlike for-profit corporations, are not subject to market discipline. Therefore, without membership control of major decisions such as election and dismissal of the directors, confirmation of articles and by-laws, and approval of fundamental changes, there are few safeguards against oversight, misstep or abuse.[178]

[174] Members participate - either directly or, most often, indirectly through the elected directors – in the proposal, development and implementation of governing rules, corporate policies and other initiatives that may impact the activities or affairs of the corporation. Collectively, therefore, members have a role to play in the stewardship of the corporation.

[175] In general, the members of a corporation, in that capacity, are not liable for the defaults, acts or omissions of the corporation.[179] When defining the extent

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tracking purposes. The list of registered members should be accessible to the members of the corporation, but not to the public. This issue is further discussed in the *Access to Information* section below.

[178] As non-profit corporations grow and seek public funding and larger donations, the degree of scrutiny by the corporate authorities and the general public may increase, including expectations of financial disclosure and review. See the *Financial Accountability and Transparency* section below.

[179] See, for example, *Societies Act*, s 21; CNCA, s 36.

of member rights, it should be borne in mind that, contrary to a corporation's directors and officers, members do not owe any fiduciary duties to the corporation, and will not be held personally responsible for decisions taken in an organization, except if the powers of the directors to manage the corporation, and to the same extent their duties and liabilities, can be transferred to the members through unanimous agreement.[180]

RECOMMENDATION 27

The new act should state that members, in that capacity, are not liable for a debt or other liabilities of the corporation, unless otherwise provided. Educational materials should define the roles and responsibilities of the members.

C. Rights of Members

ISSUE 13

What member rights contribute to ensuring greater effectiveness in carrying out non-profit purposes? (Recommendations 28 to 39)

[176] The democratic participation in non-profit corporations must be secured by rights, which are usually defined in the incorporating statute and the governing documents. Non-profit corporate statutes modelled on their for-profit counterparts give members rights similar to those of shareholders, such as the right to elect and remove directors, make proposals, requisition a meeting of members, and vote on certain amendments to the articles and fundamental changes.[181]

[177] Part of the problem with transplanting shareholder rights into non-profit legislation is that the individual rights of the shareholders of a for-profit corporation do not necessarily relate to the collective roles of the members of a non-profit corporation. Shareholders, especially those who do not otherwise

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[180] For instance, members are not obligated to act in the corporation's best interests, and can vote in their own interests. However, where members enter a unanimous member agreement, that is, an agreement that restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the activities and affairs of the corporation, they take on all the rights, powers, duties and liabilities of a director of the corporation to that same extent: see CNCA, s 170(5).

[181] This also means that the members of an organization incorporated under this type of statute (e.g. the CNCA, ONCA and Saskatchewan Act) are able to pursue shareholder remedies, including oppression remedy, derivative action, compliance or restraining orders and rectification orders. See discussion in the *Corporate Remedies* section below.

have the right to vote, need ways to oppose changes that could adversely affect their financial interests (e.g. the value of their shares). In most cases, members do not have the same sort of stake in a non-profit corporation. If they do, it should be up to the corporation, not the act, to make sure that members have individual rights that match their specific ownership stake. Individual corporations which have members with interests similar to those of shareholders should be free to give members shareholder-like rights. However, the incorporation statute does not have to go to the same length.

[178] Enhanced voting rights may be particularly problematic in the non-profit context. For example, the CNCA provides that members of each class of membership, whether or not a class carries the right to vote are entitled to vote separately as a class to approve any changes to the articles or by-laws that may affect that class, or certain fundamental changes.[182] To pass, a resolution must be approved by the members of each separate class. As a result, the members of any class, including members who were not meant to participate in the democratic governance of the organization, can veto changes that may have otherwise been approved by the membership.[183]

[179] Although the act should allow members of voting classes to vote separately on certain matters that may affect their class, it does not follow that classes of members who were not intended to vote in the first place should be given any voting rights under the act. Non-voting members should not be entitled to vote, unless the corporation chooses to confer such right on the members of a non-voting class with respect to specific issues affecting that non-voting class of members. As previously discussed, however, corporations should be encouraged to tie governance to membership and avoid the creation of non-voting member classes.

RECOMMENDATION 28

Non-voting members should not be entitled to vote, unless a corporation expressly confers rights on them with respect to specific matters affecting the non-voting class of members.

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[182] See CNCA, ss 199, 206(4), 212(4), 212(5), 214 (5) and 214(6); Saskatchewan Act, ss 163(2), 170(3), 175(3) and 176(7).

[183] Many organizations have created classes of non-voting members to ease the problems of a very diverse membership (e.g. having donors, little league players or clients as non-voting members). However, under the CNCA and the ONCA, even non-voting members may be able to vote on certain issues. As a result, corporations governed by these statutes have now begun to narrow and limit membership.

[180] Members make decisions by voting on resolutions at general or special meetings of the members. Where authorized, they may also sign written resolutions instead of holding meetings.[184] The directors of a corporation are generally responsible for calling annual and special meetings.[185] In certain cases, members who hold a certain percentage of the votes may require the directors to call a meeting of members.[186] Corporate legislation usually provides that members may participate in meetings by telephone or by electronic or other communication means, unless otherwise provided by the by-laws.[187]

[181] A corporation's by-laws may also contain provisions to allow members who cannot attend a meeting to cast their votes by other means, including online, mailed-in and proxy voting.[188] Although designed to enhance member rights, such means of voting entail logistical support that can quickly strain the resources of non-profit corporations, especially those with a broad membership base. In the case of proxy voting, there is also the question of whether this feature is suitable for corporations without share capital. While a proxy can vote for what is consistent with the financial interest of an individual shareholder, this may be more difficult when no such interests are at stake. The decision to allow proxy voting should thus be a carefully weighed choice. As a result, we do not think that the act should expressly permit or prohibit online, mailed-in or proxy voting; it should be up to each corporation to decide whether or not to allow a manner of absentee voting.

RECOMMENDATION 29

Participation in meetings by telephone or by electronic and other communication means should be allowed, unless otherwise provided in the corporation's by-laws. Other matters, such as a resolution in writing, a decision by consensus or online, mailed-in and proxy voting, should be left to each corporation to determine.

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[184] Resolutions in writing require the signatures of all of the members entitled to vote at meetings of the members: see CNCA, s 166.

[185] For example, see CNCA, ss 160 and 167. A corporation must hold an annual meeting within the prescribed period after holding the preceding annual meeting but no later than the prescribed period after the end of the corporation's preceding financial year. A special meeting is generally called to make decisions concerning special business such as the approval of a fundamental change. The right to sufficient notice of a meeting is discussed in the *Access to Information* section below.

[186] See discussion in the *Corporate Remedies* section below.

[187] See, for example, CNCA, s 159(4)–(5).

[188] See, for example, CNCA, s 171.

[182] The by-laws should set out the quorum requirement, that is, the minimum number of members who must be present at a meeting to make the decisions binding on the corporation. The quorum requirement can be a fixed number of members, a percentage of members, or a percentage of members that is determinable by a formula. However, we think that the act should include a default provision – providing, for example, that a quorum is a majority of members entitled to vote at the meeting – to help corporations where the by-laws are silent on the subject.[189] The act should also require corporations to keep a written record of each meeting of members.

RECOMMENDATION 30

The act should include a default provision with respect to the quorum requirements.

[183] Members have the right to vote and entitlements should flow from the necessity of voting. Generally speaking, however, we think that those should be collective entitlements, as opposed to individual entitlements, which implies some degree of support by the membership as a whole (e.g. members who hold a prescribed percentage of votes may requisition a meeting or submit nominations for the election of directors).

[184] Member entitlements can be divided into four main categories: (1) access to information, (2) supervision of decision-making, (3) participation in decision-making, and (4) termination of membership. However, the question is who should be entitled to what rights and on what basis. We think that the starting point should be to secure basic rights in the act, while freeing up corporations to tailor member rights to the needs and expectations of their particular membership.[190]

1. ACCESS TO INFORMATION

[185] Access to information is often a prerequisite to the meaningful exercise of member rights, including the right to participate in the governance of the corporation. Member participation first requires that those entitled to vote at a

[189] Whether a person is "entitled to vote at a meeting" depends on the cut-off date at which a person must meet the conditions for membership. This cut-off date is used to calculate quorum or resolution requirements. See, for example, CNCA, s 164.

[190] For example, members who pay equity membership, initiation fees and/or significant annual dues generally may expect enhanced rights that allow them to protect their investment.

general or special meeting receive a notice of meeting, along with all relevant materials.[191]

[186] For example, the CNCA requires a corporation to give members entitled to vote at a meeting a notice of the time and place of the meeting.[192] The Act also makes it mandatory to set out the method or methods used to provide members with notices of meeting in the corporation's by-laws. The options, along with the time period for each option, are defined in the regulations: [193]

- by mail, courier or personal delivery, during a period of 21 to 60 days before the day on which the meeting is to be held,
- by telephone, electronic or other communication facility, during a period of 21 to 35 days before the day on which the meeting is to be held,
- by affixing the notice, no later than 30 days before the day on which the meeting is to be held, to a notice board on which information respecting the corporation's activities is regularly posted and that is located where the members usually attend, and
- in the case of a corporation that has more than 250 members, by publication in a newsletter of the corporation at least once during a period of 21 to 60 days before the day on which the meeting is to be held, or in a public newspaper at least once in each of the three weeks immediately before the day on which the meeting is to be held.

[187] On balance, we think that the act should require a corporation to give members sufficient notice of a meeting. However, the details of what constitutes a sufficient notice, such as time periods and notice methods, should be left to be set out in the corporation's by-laws. The use of information technologies should also be allowed where appropriate. The act should provide that only members entitled to vote at a meeting, that is, those who meet the conditions of membership at the "cut-off" date, have the right to receive the notice of meeting.

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[191] See, for instance, *Societies Act*, s 25. In addition, members who hold a certain percentage of votes have sometimes the right to requisition a meeting for a specific purpose. See, for instance, CNCA, s 167. The by-laws should set out the manner in which notice can be given to members entitled to vote. However, by-laws cannot include provisions that are inconsistent with the governing statute.

[192] CNCA, s 162.

[193] *Canada Not-for-profit Corporations Regulations*, SOR/2011-223, s 63.

As previously discussed, one of those conditions should be registration on the list of members by a certain date before the meeting.[194]

RECOMMENDATION 31

The new act should require corporations to give sufficient notice of a meeting to members entitled to vote at that meeting. Members should be able to waive the notice requirement. The time periods and notice methods should be set out in the corporation's by-laws.

[188] In addition to receiving notices of meetings and any materials necessary to their participation in the discussion, deliberation and voting process, members usually have a right to examine and make copies of corporate records, including the articles and by-laws, and any amendments to them, the list of members, the minutes of the members' meetings, and the resolutions of the members.[195] Generally, members also have access to information that enables them to oversee the directors' decisions, such as the portions that contain disclosures, the register of any debt obligations, and the financial statements and reports of auditors, if any.[196]

[189] Access to corporate records and information should be limited to voting members. Non-voting members should not have any entitlements under the act except for a copy of the corporation's articles of incorporation and/or by-laws upon request.[197] In other words, a corporation should be able to give particular access rights to non-voting members but should not be obligated to do so.

[190] The act should also set out access rules and procedures.[198] However, instead of referring to concepts such as "examining during usual business

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[194] See, for example, CNCA, ss 161-162.

[195] See, for instance, *Societies Act*, ss 30 and 36.

[196] Generally, members do not have access to the minutes of the directors' meetings, except for the portion containing disclosures required by the incorporation statute, such as conflict of interest disclosures. The issue of financial disclosure is further discussed in the *Financial Accountability and Transparency* section below.

[197] *Societies Act*, s 30.

[198] For example, the BCA, ss 21(1) and 23(1) provides that:

> **Corporate records**
>
> **21(1)** A corporation shall prepare and maintain at its records office records containing
>
> (a) the articles and the bylaws, all amendments to the articles and bylaws, a copy of any unanimous shareholder agreement and any amendment to a unanimous shareholder agreement,
>
> (b) minutes of meetings and resolutions of shareholders,
>
> (c) copies of all notices required by section 106 or 113,
>
> (d) a securities register complying with section 49,
>
> (e) copies of the financial statements, reports and information referred to in section 155(1), and
>
> *Continued*

hours", "making copies" or "taking extracts", the act should articulate rules and procedures that are more in line with what can be done using today's communication technologies.

RECOMMENDATION 32

The new act should provide that the voting members of a corporation have the right to access the records of the corporation. Unless otherwise provided by the corporation's by-laws, non-voting members' access to corporate records should be limited to the articles of incorporation and by-laws upon request. The act should take a modern approach to access to information and allow the use of today's communication technologies.

[191] Generally speaking, information to which members are entitled in their capacity as members should not be used for purposes unrelated to the activities or affairs of the corporation or circulated outside the membership, unless the corporation or members concerned agree to such use or disclosure.[199] How and when it may be appropriate to limit the use and disclosure of that information to certain purposes should be left to the corporations. To this end, the act should include a provision expressly allowing corporations to impose on members any restrictions they see fit in their by-laws.[200]

(f) a register of disclosures made pursuant to section 120.

Access to corporate records

23(1) The directors and shareholders of a corporation, their agents and legal representatives may examine the records referred to in section 21(1) during the usual business hours of the corporation free of charge.

(2) A shareholder of a corporation is entitled on request and without charge to one copy of the articles and bylaws and of any unanimous shareholder agreement, and amendments to them.

[199] The *Societies Act*, s 36.1 provides that:

Use of register

36.1(1) In this section, "personal information" means personal information as defined in the Personal Information Protection Act other than business contact information to which that Act does not apply by virtue of section 4(3)(d) of that Act.

(2) Notwithstanding section 36, a society may disclose the register or an annual list of members or an excerpt of either or both of them to a member of the society only if the information contained in the register, list or excerpt is to be used by the member for matters relating to the affairs of the society.

(3) A member of a society may use personal information about another member of the society that is contained in the register, list or excerpt for any matter not referred to in subsection (2) if that other member gives consent to that use.

[200] Some jurisdictions go a bit further by expressly prohibiting members from using information for purposes other than those defined in the legislation. For example, the CNCA, s 23(7) provides that:

Use of information or list by members

23(7) A member or a member's personal representative who obtains a list of members or information from a register of members under this section shall not use the list or information except in connection with

(a) an effort to influence the voting of members;

(b) requisitioning a meeting of members; or

(c) any other matter relating to the affairs of the corporation.

[192] We do not think, however, that the new act should include any offence and penalty for using information for a purpose other than those specified in the act.[201] Recourses for unauthorized use or disclosure under the act should be limited to those that corporations choose to set out internally in their by-laws (e.g. disciplinary actions). This should not preclude other causes of action or remedies otherwise available to corporations or individuals, such as those provided under privacy law, where applicable.

RECOMMENDATION 33

The new act should expressly provide that corporations have the power to limit the use and disclosure of corporate information by members and set out internal sanctions, without prejudice to legal actions by corporations or individuals at common law or statute.

2. SUPERVISION OF DECISION-MAKING

[193] The members of a non-profit corporation generally have supervision rights that at least include the right to elect and remove directors, the right to approve key amendments to governing documents and fundamental changes, and the right to ensure that the directors and officers use their powers in accordance with the incorporating statute, the articles and the by-laws.

[194] The main way for members to participate in the governance of a corporation is through elected directors. Directors are generally elected by ordinary resolution at the first meeting of the members, and at subsequent annual meetings where required. Corporate legislation often allows members to put forward proposals for nominations for the election of directors if the proposals are signed by a prescribed percentage of the members (e.g. 5%).[202] Directors may usually be removed from office by ordinary resolution of the members at a special meeting.[203] The same percentage of members should also be entitled to submit proposals for the removal of directors.

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[201] For example, the CNCA, s 262(3) provides that:

> **Offence — use of information**
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> **262(3)** A person who uses information obtained from a register of members or debt obligation holders or a list of members or debt obligation holders required under this Act for a purpose other than those specified in section 22, 23 and 107 without the written permission of the member or debt obligation holder about whom information is being used is guilty of an offence and liable on summary conviction to a fine of not more than $25,000 or to imprisonment for a term of not more than six months or to both.

[202] See, for example, CNCA, s 163(5).

[203] See CNCA, s 130.

RECOMMENDATION 34

The new act should provide that proposals to elect or remove directors from office may be submitted by the percentage of the voting members prescribed in the act or regulations; the actual election or removal of the director should be by majority vote.

[195] As previously discussed, the members of a newly incorporated corporation generally have to confirm the by-laws at the first meeting of the members. Any subsequent amendments also have to be approved by ordinary resolution of the members. Some statutes, however, provide that amendments affecting member rights, especially voting rights, require member approval by a special resolution of two-thirds of the members entitled to vote at the meeting where the matter is submitted.[204] Such provisions are generally designed to prevent directors from using amendments to the by-laws to exclude dissident members or otherwise manipulate the votes.

[196] Amendments to a corporation's articles, which usually contain key elements, have to be approved by special resolution of the members or unanimous resolution in writing. This includes changes to the name of the corporation, the stated purpose, the classes of membership, the number of directors, the distribution on dissolution, and any restrictions on the powers or activities. Fundamental changes, such as amalgamation, continuance, sale or disposition of substantially all assets, and liquidation and dissolution, also have to be approved by special resolution.[205] In addition, voting members generally have the right to vote separately as a class on amendments that specifically affect that class.[206]

RECOMMENDATION 35

Amendments to the by-laws should require approval by ordinary resolution of a majority of the members entitled to vote at the meeting, unless otherwise provided. Amendments to the articles

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[204] See, for example, CNCA, s 197. Special by-law amendments include changes to the conditions for membership; the time period or method used to provide notices of meetings; the manner of voting, including absentee voting; and the transfer of membership.

[205] See discussion in the *Fundamental Changes* section below.

[206] See, for example, CNCA, s 199. Under the CNCA, each member is now entitled to vote, unless otherwise provided in the corporation's articles or by-laws. In some cases, non-voting members, both individually and as a class, have the right to vote on matters affecting their membership rights (e.g. the creation of a new class of members or modification to conditions of membership) but also on other fundamental changes (e.g. amalgamation, continuance or extraordinary disposition of the assets of the corporation). These issues are treated in more details in the *Fundamental Changes* section below.

and fundamental changes should require approval by special resolution of two-thirds of the members entitled to vote at the meeting or unanimous resolution in writing. The new act should provide that the members of each voting class have a right to vote separately as a class on amendments or changes that specifically affect that class.

[197] Although fiduciary duties are generally owed to the corporation as such, directors and officers also have duties to the members. First and foremost, they must ensure that the corporation abides by the incorporating statute, but also by the terms of the articles and the by-laws, which courts have considered akin to a contract between the corporation and its members.

[198] Members have the right to ensure that a corporation – through its directors and officers – uses its powers to further the stated purpose, and no other. As previously discussed, the act should allow members who think that a corporation has acted outside the stated purpose to submit a proposal to raise the matter at a general or special meeting of the members if enough members signed the proposal (e.g. at least 10%). When necessary, members could then decide whether to approve or confirm the decision by a resolution of the members.

[199] The incorporating statute and governing documents may also provide that certain transactions require the approval of the members. For example, under the *Societies Act*, a society cannot borrow money or give guarantees without being authorized by special resolution.[207] A corporation's articles may contain similar restrictions. We do not think that the new act should carry over this type of provision. It should instead leave it up to individual corporations to make the exercise of specific powers subject to the approval of members.

RECOMMENDATION 36

The new act should provide that the matter of whether a corporation has acted outside the stated purpose may be raised at an annual or special meeting if the percentage of the voting members prescribed in the act or regulations signed the proposal.

3. PARTICIPATION IN DECISION-MAKING

[200] Directors and officers are generally in the position of having the greatest information, and thus are better equipped to manage the corporation. Members

[207] *Societies Act*, s 18.

do not oversee the management of the corporation and may not be able to appreciate the full impact of their interventions. The right to supervise the decision-making process is often enough to ensure that the interests of the members are protected. But there are also ways members can provide direct input, including member proposals.

[201] Directors are responsible for calling member meetings and setting the agenda. However, some statutes allow members to add items to the agenda by submitting a proposal in advance of that meeting. For example, the CNCA provides that a member entitled to vote at a general meeting may submit to the corporation a notice of any matter that he or she proposes to raise at the meeting, and discuss that matter at the meeting.[208] The corporation is then required to include the proposal in the notice of meeting.[209]

[202] Although individual proposals are not necessarily against the collective will, they can be costly if brought time and time again. To reduce the risk of abuse, it may be preferable to restrict the use of individual proposals. In other words, members should only be allowed to submit a proposal if signed by at least a certain percentage of voting members. The prescribed percentage could vary depending on the type of proposal. Corporations should also be free to set a different percentage in their by-laws.

[203] The act could also limit member proposals to certain matters, such as nomination for the election of directors, amendment to the by-laws or articles (e.g. change of stated purpose), fundamental changes (e.g. voluntary dissolution), and any other matters connected to the management of the corporation (e.g. deviation to stated purpose). However, the act should make it

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[208] The CNCA, s 163; and *Canada Not-for-profit Corporations Regulations*, SOR/2011-223, ss 64–69.

[209] The CNCA, s 163(6) provides that directors are not obliged to include the proposal if:

> **Exception**
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> **163(6)** A corporation is not required to comply with subsections (2) and (3) if
>
> (a) the proposal is not submitted to the corporation within the prescribed period;
>
> (b) it clearly appears that the primary purpose of the proposal is to enforce a personal claim or redress a personal grievance against the corporation or its directors, officers, members or debt obligation holders;
>
> (c) it clearly appears that the proposal does not relate in a significant way to the activities or affairs of the corporation;
>
> (d) not more than the prescribed period before the receipt of the proposal, the member failed to present — in person or, if authorized by the by-laws, by proxy — at a meeting of members, a proposal that at the member's request had been included in a notice of meeting;
>
> (e) substantially the same proposal was submitted to members in a notice of a meeting of members held not more than the prescribed period before the receipt of the proposal and did not receive the prescribed minimum amount of support at the meeting; or
>
> (f) the rights conferred by this section are being abused to secure publicity.

clear that the usual statutory procedures and requirements would still have to be met to implement the proposal.[210]

RECOMMENDATION 37

The new act should allow members to submit a proposal to the corporation about any matter they wish to raise at an annual or special meeting of the members. The act should require the proposal to be signed by the percentage of the voting members prescribed in the act or regulations, unless otherwise provided by the corporation's by-laws.

4. TERMINATION OF MEMBERSHIP

[204] Membership in a corporation is normally terminated if:

- the member dies,
- the member's term of membership expires,
- the member does not pay the membership dues,
- the member is expelled,
- the member resigns,
- the member transfers their membership, or
- the corporation is liquidated and dissolved.

[205] The rights and privileges of the member cease to exist when the membership is terminated, unless otherwise provided by the incorporating statute or governing documents.[211] There may, however, be certain exceptions to that rule.

[206] Members may choose to terminate their membership. Generally speaking, membership rights, including any rights in the property of the corporation, are not reimbursable or transferable, unless otherwise provided by the corporation's governing documents. In some cases, however, members, especially those with

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[210] For instance, approval requirements would need to be satisfied in order to amend the articles or the by-laws.

[211] For instance, the incorporation statute may provide that members who object to important changes can terminate their membership and be paid the fair market value of their membership if certain requirements are met. The issue of dissent and appraisal is discussed in the *Corporate Remedies* section below.

significant financial interests in the corporation, expect to be able to transfer their membership to their spouse on their death or to sell it on the market if they so choose. Where a corporation allows transfer of memberships, the by-laws should prescribe the process to be followed, including board approval and fees, if any.

RECOMMENDATION 38

The new act should provide that a membership in a corporation is not transferable, unless otherwise provided in the corporation's governing documents. To the extent it is permitted, the corporation's by-laws should set out the procedures and requirements for the transfer of membership.

[207] In certain circumstances, corporations may also be allowed to discipline members or terminate memberships. However, to protect members, discipline or termination of membership may be subject to certain rules. For example, the CNCA provides that directors, members or any committee of directors or members may be granted the power to discipline members or to terminate their membership. If the articles or by-laws provide for this power, they must also prescribe the procedures for disciplining a member or terminating a membership.[212]

[208] Members are usually entitled to basic procedural rights, including the right to be given fair notice and to be heard (or provide submissions) if disciplinary action or termination of membership is contemplated.[213] The extent of those procedural rights may vary depending on what is being addressed (e.g. a member may not be entitled to a hearing where the termination is for non-payment of membership fees).

[209] The articles or by-laws should also specify whether the decision to discipline a member or to terminate the membership is final and binding on the member, or is subject to review or appeal. Generally, if the directors or a committee of directors make that decision, there should be a review or appeal mechanism independent of the board. However, if the members or a committee of the members make the decision, it should not be subject to review or appeal, absent discrimination or non-compliance with the act or the governing documents.

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[212] CNCA, s 158. See also Saskatchewan Act, s 119.

[213] See Saskatchewan Act, s 120.

[210] We think that non-profit corporations should be encouraged to provide for member discipline and termination in their governing documents. The act should also make it clear that where a corporation chooses to give directors, members or any committee of directors or members the power to discipline a member or terminate his or her membership, the by-laws have to define the extent of that power and what it entails, including grounds, procedures and sanctions. Termination by decision of the corporation should not entitle a member to any reimbursement of membership dues, unless otherwise provided by the governing documents.

RECOMMENDATION 39

The new act should provide that corporations have the ability to give directors, members or any committee of directors or members the power to discipline members or terminate their membership. Corporations that choose to include a power to discipline members or terminate their membership in their governing documents should be required to set out in their by-laws the circumstances and manner in which such power can be exercised. The act should include default provisions with respect to procedural requirements and review mechanisms.

CHAPTER 5

Financial Accountability and Transparency

[211] Financial accountability and transparency are important components of good governance. Financial accountability refers to an obligation or willingness to explain a corporation's financial situation to stakeholders. Transparency refers to an obligation or willingness to make financial data available. Different types of non-profit corporations may warrant different levels of financial accountability and transparency, depending on the size of the organization, whether they provide services primarily for the membership or the general public or whether they are publicly or privately funded.

[212] Financial accountability and transparency can buttress the sustainability of an organization by satisfying funders, donors, members and beneficiaries that the corporation is efficiently and effectively pursuing its objects. However, it also requires a significant investment of time and money which may put strain on often limited resources.

[213] When one thinks of the financial accountability and transparency of non-profit corporations, two broad issues arise: (1) What should be the level of financial disclosure? To whom? (2) What should be the level of financial review? This section raises each of these broad issues and considers whether or not they should be included in a clear and enabling legislative framework.

A. Financial Disclosure

ISSUE 14

What should be the required level of financial disclosure? To whom?
(Recommendations 40 to 44)

1. ANNUAL FINANCIAL STATEMENTS

[214] A corporation is required to place annual financial statements before its members. Annual financial statements are typically prepared in accordance with acceptable accounting standards. The Canadian Accounting Standards Board adopted new financial reporting standards for non-profit organizations that went

into effect for fiscal periods beginning on or after January 1, 2012.[214] The new standards are intended to increase transparency and accountability.[215]

[215] Currently, Alberta legislation provides that financial statements shall be made available at the annual general meeting.[216] More recent non-profit corporate legislation goes further and provides that financial statements should be disclosed to members in advance of the annual general meeting. For instance, the CNCA provides that each member, other than a member who has declined to receive such documentation, is entitled to get a copy of the comparative financial statements before the annual meeting.[217]

[216] The advantages of providing the statements to members in advance of the annual general meeting are that it would give members more time to review the statements and they would be better prepared to vote on the financial statements. The disadvantages are the costs and resources required to distribute the statements in advance of the meeting.

[217] Although it is good practice to provide the financial statements to members in advance of the annual general meeting, it may not always be possible for an organization to do so. We agree that corporations should strive to give their members as much time as possible to review the statements, but we do not think that it should be a legislative requirement. Instead, the act should provide that a corporation must at minimum make the statements available to members at the annual meeting.

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[214] Chartered Accountants of Canada, *Guide to Accounting Standards for Not-for-Profit Organizations in Canada*, (Toronto: The Canadian Institute of Chartered Accountants, 2012), available online at: <www.cica.ca/focus-on-practice-areas/small-and-medium-practices-(smp)/implementing-the-accounting-standards/item69429.pdf>.

[215] Carters, Newsletter, "Charity Law Update", (July/August 2012), available online at: <www.carters.ca/pub/update/charity/12/julaug12.pdf>. The new standards distinguish between non-profit corporations that are controlled by the government and those that are not. Under the new standards, private non-profit corporations must choose to follow either Part I of the CICA Handbook (International Financial Reporting Standards) or Part III. It is expected that most non-profit corporations will choose Part III because it is designed specifically for non-profit corporations and is similar to the previous standards.

[216] Section 25 of the *Societies Act* states: "A society shall hold an annual general meeting in Alberta and shall present at that meeting a financial statement setting out its income, disbursements, assets and liabilities, audited and signed by the society's auditor". Section 26(2)(d) requires a society to include the audited financial statement presented at its last annual general meeting in the annual return to the corporate authorities. Section 147(1) of the *Companies Act* provides that financial statements of public companies shall be provided to shareholders 10 days in advance of the annual meeting and s 147(2) provides that shareholders of private companies can demand copies of financial statements.

[217] The by-laws may authorize the corporation to give members notice that the statements are available at its registered office: see CNCA, s 175. Section 146 of the Saskatchewan Act requires that financial statements be sent to members 15 days in advance of the annual general meeting.

RECOMMENDATION 40

The new act should require that annual financial statements be prepared and placed before the members at the annual general meeting.

2. ACCESS TO FINANCIAL STATEMENTS

[218] A related question concerns access to financial statements outside of the annual general meeting by members and the general public. Some statutes distinguish between different classifications of non-profit corporations. For example, section 144 of the Saskatchewan Act distinguishes between member and charitable corporations. A member organization is required to allow its members access to financial statements at its corporate office during regular business hours. A charitable organization, on the other hand, is also required to provide access to its financial statements to any person, including members of the public, on written notice. Both access provisions are subject to a court order to the contrary.

[219] Access to corporate records, including the books of the corporation, is essential to efficient governance. Therefore, the new act should make it clear that people who participate in the governance of a corporation, that is, directors, officers and voting members, have a right to access the financial statements upon request. [218] As previously discussed, corporations should, however, have the ability to limit the use or disclosure of information obtained from the financial statements by setting out restrictions in their by-laws if they so choose.[219]

[220] While some non-profits – especially public benefit corporations which rely on donation-based funding – may be hard-pressed not to publish their financial statements, we do not think that it is the place of the incorporation legislation to extend the right to access a corporation's books and records to the general

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[218] As previously discussed, the directors and voting members of a corporation, their agents and legal representatives should be entitled, on request, to examine or copy corporate records, including the financial statements. See the *Access to Information* section above.

[219] As part of their fiduciary duties, directors and officers are already bound by a duty to maintain and protect the confidentiality of information they receive in their respective capacity: see *Duty of Loyalty* section above. Similarly, we think that members who obtain information in that capacity should use it for purposes related to the affairs of the corporation, and not circulate it outside the membership. Corporations should also have the power to impose restrictions on members with respect to the use and disclosure of the information obtained from corporate books and records, including financial statements: see *Access to Information* section above.

public.[220] Generally, best practices should dictate a higher level of disclosure when appropriate, not the act. In other words, corporations should be free to decide whether their own situation warrants making some financial information available to a broader group of stakeholders, without being compelled to do so under the incorporation statute.[221]

RECOMMENDATION 41

Directors, officers and members should have a right to access the corporation's books and records; this right should not be extended to the general public. The use of communication technologies should also be allowed where appropriate.

[221] Corporations are sometimes required to file a copy of their financial statements with the corporate authorities. The question is whether the possibility of the general public accessing the financial statements of a corporation through a search of the corporate registry may thwart the corporation's ability to limit financial disclosure to their members if it so chooses based on the particular circumstances.

[222] For instance, the *Societies Act* states that:

> Annual report
>
> 26(1) In this section, "anniversary month" means the month in each year that is the same as the month in which the certificate of incorporation of the society was issued.
>
> (2) A society shall each year, on or before the last day of the month immediately following its anniversary month, make a return to the Registrar containing
>
> ...
>
> (d) the audited financial statement presented at the last annual general meeting of the society.

[223] The CNCA as well provides that soliciting corporations, that is, corporations that receive gifts, donations, grants or similar financial assistance from the government in excess of the prescribed amount, are required to send

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[220] Moreover, it should be kept in mind that corporations that receive grants usually have to send a copy of their financial statements to the funding bodies as part of their grant agreements.

[221] However, the new act should provide that donors have access to the financial statements of an organization as required by operation of law, for example, disclosure requirement for donors under the *Charitable Fund-raising* Act, RSA 2000, c C-9.

their financial statements to the corporate authorities every year. Both soliciting and non-soliciting corporations also have the obligation to send their financial statements when requested by the corporate authorities.[222] It is not clear, however, whether the general public can then access these statements.[223]

[224] But what are the reasons for requiring corporations which receive gifts, donations, grants or similar financial assistance from the government to file their financial statements with the corporate authorities? The primary reason given by Industry Canada is that "[s]ince soliciting corporations receive public funds, they must meet additional requirements to ensure sufficient transparency and accountability for that income".[224]

[225] The problem, however, is that the corporate authorities do not verify or approve the financial statements that soliciting corporations are required to file; they act merely as a repository. Compelling non-profit corporations which receive public funds to file their financial statements with the corporate authorities does not in itself guarantee that those funds are used to further the purposes for which they have been received. Moreover, it raises the question of why non-profit corporations should be singled out when for-profit corporations which receive public funds (e.g. small business grants, research and development programs or crowd-funding) are not subject to a similar requirement under their incorporation statute.

[226] Another reason for filing with the corporate authorities is that it provides an alternate way for stakeholders to obtain accurate copies of its financial statements through a search of the central registry.[225] While the idea of a central repository is interesting, on balance, we think that the onus to make sure that those involved in corporate governance have meaningful access to financial

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[222] CNCA, ss 176–177. While section 174(2) of the CNCA limits the right to access the financial statements of a corporation to its members, section 176(1) requires soliciting corporations to file a copy of the comparative financial statements, the report of the public accountant, if any, and any further information respecting the financial position of the corporation and the results of its operations required by the articles, the by-laws or any unanimous member agreement with Corporations Canada. Section 177 requires a corporation, soliciting or non-soliciting, to send a copy of those documents upon request.

[223] ALRI's Report 49 recommended that where a non-profit corporation had received public monies then the annual financial statements should be filed with the corporate authorities. The general public would then be able to access the financial statements via that office: see ALRI Report 49 at 19.

[224] Industry Canada, *Requirements for Soliciting Corporations under the Canada Not-for-profit Corporations Act*, available online at: <www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs05011.html>.

[225] This includes directors, officer and members but also funders and other any entities that consider doing business with a non-profit corporation.

statements should be placed on the corporations.[226] Therefore, as long as the act makes it clear that directors, officers and voting members have a right to financial information, and gives them a way to enforce that right with a corresponding obligation on corporations, we do not think that it should remain mandatory for non-profit corporations to file their financial statements with the corporate authorities.

RECOMMENDATION 42

Corporations should no longer be required to file their financial statements with the corporate authorities.

[227] A final question concerns whether the legislation should also provide for the possibility of exempting the disclosure of certain information from the financial statements where the detriment that may be caused to the corporation by the disclosure requirement outweighs its benefit to the members (or the public in cases where the legislation so extends the disclosure requirement).[227] For example, the CNCA provides that:

> Application for exemption
>
> **173.** On the application of a corporation, the Director may exempt the corporation, on any terms that the Director thinks fit, from any requirement in this Part if the Director reasonably believes that the detriment that may be caused to the corporation by the requirement outweighs its benefit to the members or, in the case of a soliciting corporation, the public.

[228] Situations in which directors may wish to retain financial information because of its confidential or sensitive nature are likely to be rare in the non-profit sector. Any need to apply for an exemption is even further diminished if the act limits the disclosure requirement to the directors, officers and voting members, as discussed above. Nonetheless, there may still be cases where it is necessary to temporarily withhold information from the members in order, for example, to preserve a competitive advantage or comply with a non-disclosure agreement during negotiations.

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[226] Generally, direct requests from potential partners, granters or important donors should also be a sufficient incentive for corporations to volunteer the information requested.

[227] Section 143 of the Saskatchewan Act provides that:

> A corporation may apply to the Director for an order authorizing the corporation to omit from its financial statements any item prescribed, or to dispense with the publication of any particular financial statement prescribed, and the Director may, if he or she reasonably believes that disclosure of the information would be detrimental to the corporation, permit that omission with any reasonable conditions that he or she considers appropriate.

[229] The CNCA places the responsibility to determine whether or not an exemption ought to be granted on the Director. In our view, however, this is not an issue that the corporate authorities would normally handle or be best equipped to deal with. We think that cases in which directors need to withhold financial information from the members would be sufficiently important and fact specific to require an application to the court for a temporary exemption. In exercising their discretion, courts should carefully balance the interest of the corporation to protect its financial position with the overarching right of the members to able to participate in the governance of the corporation in a meaningfully manner.

RECOMMENDATION 43

The new act should provide that a corporation may apply to court for an order authorizing the corporation to omit from its financial statements any item, or to dispense with the disclosure of its financial statements for a limited period of time. On the application of a corporation, a court should have the discretion to temporarily exempt the corporation from the financial disclosure requirement under the act if the court reasonably believes that the benefit or detriment to the corporation outweighs the right of the members to have access to that information.

3. OTHER FINANCIAL INFORMATION

[230] Apart from the disclosure of financial statements discussed above, the issue arises whether the legislation should include any other minimum financial disclosure requirements. For example, should members, donors or the public be able to access financial information concerning the operations of a non-profit corporation, the cost of a contract, or the cost-effectiveness of fund-raising activities?

[231] The CNCA provides that the directors of a corporation are required to place before the members "any further information respecting the financial position of the corporation and the results of its operations required by the articles, the by-laws or any unanimous member agreement".[228] It is unclear, however, whether this requirement is broad enough to give access to the type of information described above.

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[228] CNCA, s 172(1)(c).

[232] Generally speaking, financial disclosure does not extend to financial information other than that contained in the financial statements. To date, no Canadian jurisdiction has included such a requirement in non-profit corporate legislation. Although the inclusion of such a provision may be an incentive for directors and officers to use funds most effectively, we do not think that it is desirable to extend disclosure requirements to all financial information.

RECOMMENDATION 44

The question of whether members should have access to financial information other than that contained in the financial statements should be dealt with through best practices; no specific requirement should be included in the new act.

B. Financial Review

ISSUE 15

What should be the required level of financial review? (Recommendation 45)

[233] In addition to the financial statements, a corporation is also required to place before its members at every annual meeting any report of a person conducting an audit or review of the financial statements of the corporation. There are essentially three levels of financial review: (1) external audits, (2) review engagements, and (3) internal audits or reviews.

[234] An external audit involves an examination by a public accountant of the company's financial records and operations to determine whether the information reported in the financial statements is presented fairly. The public accountant's objective in an audit is to express an opinion on the financial statements. While external audits provide the highest level of assurance to members and the general public, they may not always be necessary given the nature of the accounts or the dollar value involved. Further, the cost and time required to comply may be considerable especially for smaller non-profit corporations.

[235] A review engagement is also conducted by a public accountant. It provides a moderate level of assurance. A review engagement consists primarily of enquiry, analytical procedures and discussion. In a review engagement, the objective is to determine whether the financial statements are plausible in the circumstances.

[236] An internal audit or review is conducted by board members or members of an organization appointed at the preceding annual general meeting. It is inexpensive, but may not provide the level of assurance as a review by a public accountant.

[237] The *Societies Act* requires an audited financial statement be presented at a society's annual general meeting.[229] It does not specify whether it should be an internal or external audit. Subsection 1(4) of the *Societies Regulation* provides that:[230]

> **1(4)** The audited financial statements that must accompany the annual return need not be audited by a professional accountant unless
>
> (a) the by-laws of the society so require, or
>
> (b) a fee is being charged to perform the audit.

[238] In practice, it is very common for a society's financial statements to be prepared by way of an internal audit by two persons designated for that purpose. The audited statement must also be submitted to the corporate authorities as part of the society's annual return.[231]

[239] Under the *Companies Act*, a non-profit company must annually appoint one or more auditors.[232] The requirements are different for private and public companies. A private company may waive the audit requirement by unanimous vote of its members.[233] In contrast, there are no provisions that would allow a public company to waive the audit requirement. In addition, a public company cannot appoint one of its directors, officers or employees as an auditor.[234]

[240] More recent non-profit statutes provide for a range of financial review. For instance, the financial review requirements under the CNCA vary according to the classification of the corporation.[235] A soliciting corporation with gross annual revenues of $50,000 or less has to undergo a review engagement, unless members instead require an external audit by ordinary resolution. If revenues

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[229] *Societies Act*, s 25.

[230] *Societies Regulation*, Alta Reg 122/2000, s 1(4).

[231] *Societies Act*, s 26.

[232] *Companies Act*, s 131.

[233] *Companies Act*, s 134.

[234] *Companies Act*, s 132(2).

[235] The CNCA classifies corporations based on: (1) the type of corporation, that is, soliciting or non-soliciting, and (2) the gross annual revenues, that is, designated or non-designated.

are between $50,000 and $250,000 an external audit is usually conducted, but members may pass a special resolution to reduce it to a review engagement. However, an external audit is mandatory if revenues are more than $250,000. For non-soliciting corporations, the threshold is set at $1 million.[236]

[241] One option for Alberta is to follow the CNCA model and set out the financial review requirements in the legislation. The advantages of this approach are a greater degree of uniformity and more assurance of accountability. The disadvantages are that the dollar value cut-off or the description of the classification of organization to which the various review requirements should apply may be somewhat arbitrary or artificial. Accordingly, in some cases, organizations may find they are subject to a review requirement that is unnecessary or prohibitively expensive or time-consuming. The inclusion of a waiver provision may provide more flexibility, but it may also weaken the level of accountability.

[242] Another option is to leave financial review requirements to be determined by the corporation itself. This is essentially the situation under the *Societies Act*. Non-profit organizations can draw from guidelines such as those set up by Imagine Canada in determining the appropriate level of financial review.[237] The advantages of such an approach are that the organization can tailor the level of financial review that best meets the dollar value and complexity of their accounts. Those organizations that rely on external funding will introduce the level of review that would give their funders comfort. The disadvantages are a lack of uniformity and the possibility for less public accountability depending on the method of financial review selected.

[243] As mentioned above, there is no doubt that financial review plays an important role in the development of an accountable non-profit sector. However, available options should be looked at in the broader context; non-profit corporate legislation is not the only source of obligations or pressures that can drive the type of review.[238] Ultimately, corporations may be in a better position to

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[236] See Part 12 of the CNCA for the full classification scheme.

[237] Imagine Canada, *Standards Program for Canada's Charities and Non-Profits*, April 2012, at 6, available online at: <www.imaginecanada.ca/files/www/en/standards/standards_program_handbook_may_2012.pdf>. Imagine Canada provides that organizations with annual review in excess of $1 million have an external audit and that other organizations have a review engagement unless required by their governing legislation to do otherwise.

[238] For example, a private foundation that is closely held by a small group of people familiar with the financial position of the foundation may be satisfied with a simple "internal audit". Whereas a larger public benefit organization may require an external audit to meet the transparency expectations of its donors. In addition, some provincial and federal statutes such as fundraising and tax legislation set out financial

Continued

determine the level of financial review they must meet to satisfy the demands of their stakeholders (e.g. funders, grantors or members). Accordingly, we think that it should be up to each corporation to specify the level of financial review required in its by-laws. Corporations should have the obligation to review this decision every year at the annual general meeting. The new act should, however, include a default provision requiring the conduct of a review engagement where the by-laws are silent.

RECOMMENDATION 45

The appropriate level of formality – internal audit, review engagement or external audit – required for the financial reports should be determined by members of the corporation itself. However, the new act should provide that a review engagement is to be conducted where a corporation's by-laws are silent in this regard.

review requirements; the question is whether there is a need to duplicate requirements that are already found in other statutes. The *Charitable Fund-raising Act*, RSA 2000, c C-9 no longer requires the financial statements to be audited.

CHAPTER 6

Fundamental Changes

ISSUE 16

What provisions concerning fundamental changes should be included in the non-profit corporate legislation? (Recommendations 46 to 50)

[244] Changes to the structure or nature of a corporation are considered fundamental. Generally, a corporation can make changes without resorting to the courts. It can usually do so by a special resolution adopted by two-thirds of the members entitled to vote at the meeting where the matter is submitted and discussed.[239] Fundamental changes include:[240]

- amalgamation with another corporation,
- continuance of the corporation in another jurisdiction,
- sale of or disposition of substantially all of the corporation's assets, and
- proposal to liquidate and dissolve the corporation.

[245] Common to all of these topics is the recognition that there are gaps in the current Alberta legislation. These gaps not only fail to reflect key aspects of the non-profit sector, but also have the potential to affect the governance of the organization and member rights. Each of these individual topics is discussed below.

RECOMMENDATION 46

The act should provide that fundamental changes require a special resolution of two-thirds of the members entitled to vote at the meeting where the matter is submitted and discussed, or a unanimous resolution in writing.

[239] Members who object to such changes may have an "appraisal and dissent right", that is, the right to dissent in respect of certain fundamental changes and be paid the fair market value of membership interest, if the prescribed requirements are met. See the *Corporate Remedies* section below.

[240] Changes to the articles of incorporation, which also require approval by special resolution of the members, are discussed in the *Members' Roles and Rights* section above.

A. Amalgamation with Another Corporation

[246] Amalgamation is not common in the non-profit sector, but there may be instances where two non-profit corporations do choose to amalgamate. There are significant differences between the amalgamation procedure under the *Societies Act* and under the *Companies Act*.[241] They further differ with the amalgamation procedures under the BCA. Procedural differences aside, the effect of amalgamation is the same under all three statutes: the amalgamating corporations continue as one amalgamated company as of the date and time the amalgamation application is approved.

[247] More recent non-profit corporate statutes have adopted amalgamation provisions that are closely harmonized with their for-profit corporate statute counterparts. This gives a corporation the power to amalgamate with another corporation (or subsidiary corporation) and continue as one corporation if the amalgamation agreement is approved by special resolution of the members of each amalgamating corporation.[242]

[248] Amalgamating corporations must be incorporated under the same act; if a corporation is incorporated under another act, it must first continue that act before it can amalgamate with the other corporation(s). At a minimum, the articles of amalgamation must include:

- the corporate name of the corporation created by amalgamation,
- a new statement of purpose,
- a class of membership with voting rights,
- the minimum and maximum number of directors,

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[241] For example, the *Societies Act* provision, s 32, is far less detailed than the *Companies Act*, s 172. The *Societies Act* also requires an amalgamation agreement whereas this is optional under the *Companies Act*. Under the *Societies Act*, amalgamation is approved by the corporate authorities, whereas under the *Companies Act* this is a court approved process.

[242] When corporations amalgamate, they bring their members, assets, and liabilities into the new amalgamated entity. The original corporations do not dissolve – although they no longer have separate identities – but continue to exist within a single amalgamated corporation. However, in some jurisdictions, such as British Columbia, each amalgamating corporation is dissolved and a completely new corporation must be incorporated. The problem with this approach is that CRA considers this process as a "consolidation" rather than an "amalgamation". Normally, when two or more corporations registered as charities under the *Income Tax Act* amalgamate, the amalgamated charity may choose which registration (business number) it will retain and use; the other business number(s) will be terminated. But when corporations are considered to have consolidated, instead of amalgamated, the resulting corporation needs to submit a new application for charitable registration and, if accepted, will usually be given a new business number.

- an election respecting the distribution on dissolution, and
- any restrictions on the powers or activities of the amalgamated corporation.

[249] Although less common in the non-profit sector, we think that amalgamation should be included in the list of fundamental changes, and that specific procedures should be clearly set out in the new act. The act should provide that if one of the amalgamating corporations is "fully restricted", that is, asset distribution restricted during existence and on dissolution, the amalgamated corporation can only be a fully restricted corporation.[243] Beyond that, the issue is largely procedural choices which are outside the scope of this Report.

RECOMMENDATION 47

The new act should set out amalgamation procedures similar to those found in the *Business Corporations Act*.

B. Continuance in Another Jurisdiction

[250] The reasons a corporation might want to continue under another jurisdiction's non-profit legislation include the following: (1) to facilitate an amalgamation, (2) to take advantage of the availability of a preferred corporate name, (3) to take advantage of legislative variations, or (4) the majority of the corporation's members have moved to another jurisdiction.[244]

[251] Continuance procedures are essential features of modern non-profit legislation. Many corporate statutes both in the non-profit and for-profit sectors now include such provisions.[245] These provisions save corporations time and money if they wish to continue in another jurisdiction. The alternative is a complex, time-consuming and costly series of steps. The *Companies Act* does not include provisions with respect to continuance from, or to, other jurisdictions.

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[243] Section 168 of the Saskatchewan Act provides that:

> **Amalgamation**
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> **168(1)** Two or more corporations, including holding and subsidiary corporations, may amalgamate and continue as one corporation.
>
> **(2)** If one of the amalgamating corporations is a charitable corporation, the continuing corporation, on amalgamation, is a charitable corporation.

[244] BCLI Consultation, at 125.

[245] See for example, BCA, ss 188-189; Saskatchewan Act, ss 174-175; CNCA, ss 209-211.

However, sections 36.2 and 36.3 of the *Societies Act* now allow corporations to continue in and out of Alberta.[246] We think that the new act should set out continuance procedures similar to the recent amendments to the *Societies Act*.

RECOMMENDATION 48

The new act should include provisions to allow both the continuance of an extra-provincial corporation in Alberta, and the continuance of an Alberta corporation in another jurisdiction.

C. Disposition of Substantially All Assets of the Corporation

[252] The *Societies Act* is silent regarding the sale, lease, exchange or disposal of substantially all the corporation's assets. Section 20(1)(l) of the *Companies Act* gives the corporation the power to "dispose of the undertaking of the corporation." There is no requirement of member approval. The *Companies Act* approach appears to be consistent with the common law where directors have complete power to dispose of the corporate undertaking without consulting the members.[247]

[253] In contrast, most modern for-profit and non-profit statutes have modified the common law rule, since leaving this type of decision to directors alone creates potential for misconduct.[248] The approach taken is essentially that a sale, lease or exchange of all or substantially all the property of a corporation constitutes a fundamental change which must be authorized by a special resolution of two-thirds of the members. As previously discussed, this may also trigger appraisal rights for dissenting shareholders.[249]

[254] A corporation, through its directors and officers, should have the powers needed to carry out the day-to-day activities it chooses to undertake to achieve its purpose, including the power to sell, lease or exchange property in the ordinary course of business of the corporation.[250] However, we think that the new act should make it clear that members have a say in whether or not a

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[246] The *Societies Act, ss* 36.2–36.3 set out a number of requirements that must be met in order for a corporation to continue in or out of Alberta, including being authorized by the members, the corporate authorities and the laws of the jurisdiction into which the corporation wishes to continue.

[247] *Daniel v Gold Hill Mining Co* (1899), 6 BCR 495 (SC) (as cited in BCLI Consultation at 123).

[248] See for example, BCA, s 190; Saskatchewan Act, s 176(3); CNCA, s 214.

[249] See discussion in the *Corporate Remedies* section below.

[250] See the *Capacity* section above.

corporation disposes of substantially all of its assets because of the significant impact this may have on the corporation's ability to pursue its operations.[251]

RECOMMENDATION 49

The new act should treat the sale, lease, exchange or disposal of substantially all of the assets of a corporation as a fundamental change requiring the approval of the members by special resolution.

D. Proposal to Liquidate and Dissolve the Corporation

[255] The liquidation and dissolution of a corporation may occur in three different ways: (1) voluntary dissolution initiated by the directors or members, (2) dissolution by the corporate authorities, and (3) dissolution by court order.[252] There are procedural differences between the *Societies Act* and the *Companies Act* concerning the dissolution, liquidation and restoration of non-profit corporations.[253] Generally speaking, voluntary dissolution takes place when a corporation's members agree, by special resolution, to proceed with a proposal to liquidate and dissolve. Administrative or judicial dissolution is the result of a failure of the corporation to commence or carry on its activities within the prescribed period, to elect or appoint directors, or to comply with certain provisions of the incorporation statute.[254]

[256] In addition to setting out procedural and approval requirements, the new act should contain rules with respect to the distribution of assets on dissolution. Both the *Societies Act* and the *Companies Act* are silent regarding what happens to surplus assets upon dissolution. Given the importance of the non-distribution

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[251] This also encompasses the situation where an organization decides to revoke its charitable status. If a decision is made to change charitable status then the organization would have to transfer its assets within one year. This action would therefore be caught by the sale of or disposition of substantially all the assets category. If the members don't agree to the revocation decision then the remedy would be that the organization would have to reapply for charitable status.

[252] The issue of member proposal for voluntary liquidation and dissolution is further discussed in the *Members' Roles and Rights* section. See also the discussion on application for dissolution by court order in the *Corporate Remedies* section below.

[253] Section 35 of the *Societies Act* imports by reference the procedures under Part 17 of the BCA with only some minor adjustments. Part 10 of the *Companies Act* contains its own detailed provisions concerning liquidation and dissolution.

[254] Voluntary liquidation and dissolution may be proposed by a director or a member entitled to vote at an annual general meeting. Court-ordered dissolution may be initiated by the Registrar or any interested person. See CNCA, ss 221–224.

constraint to the non-profit identity, the question of what should happen to this surplus is crucial.

[257] There are essentially two different legislative approaches regarding the disposal of assets upon dissolution: (1) those that are prescriptive and try to bring the corporate legislation in line with the requirements of the *Income Tax Act*, and (2) those that leave the matter to the individual corporations to determine.[255] As previously discussed, we think that the new act should establish a two-part model which would require a corporation to incorporate as a "fully restricted corporation" or a "partly restricted corporation". Fully restricted corporations would have to distribute their net assets to a body or combination of bodies described in the act, including another fully restricted corporation, a registered charity or other qualified donee within the meaning of the *Income Tax Act*.[256] Partly restricted corporations would have the option to distribute any

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[255] The CNCA provides an example of the former approach. A corporation that is a registered charity or a soliciting corporation, or a corporation that has received more than $10,000 in public money in a single fiscal year within the five years before distribution must distribute its remaining assets to one or more qualified donees, as defined in the *Income Tax Act* (CNCA, s 235; *Canada Not-for-profit Corporations Regulations*, SOR/2011-223, s 37). For all other corporations, assets must be distributed in accordance with the articles, or in equal shares among the members if the articles are silent on this issue (CNCA, s 236). For variations on this approach, see BCLI Report at 20. In contrast, rather than a specific legislative provision concerning the disposal of assets upon dissolution, ALRI Report 49 proposed to leave individual corporations "free to enter into such restrictions upon its activities as are necessary to conform to the *Income Tax Act*." However, ALRI Report 49 recommended the inclusion of a default provision where a corporation's articles are silent on the issue: see ALRI Report 49 at 22.

[256] For example, see Saskatchewan Act, s 209:

> **Distribution of remaining property**
>
> **209(1)** After paying all claims or after making adequate provision to pay all claims against a corporation, the liquidator shall transfer any remaining property of the corporation in accordance with this section.
>
> **(2)** Where a person has transferred property to a corporation subject to the condition that it be returned to him or her on the dissolution of the corporation, the liquidator shall transfer that property to that person.
>
> **(3)** The liquidator shall transfer any remaining property of a membership corporation other than property mentioned in subsection (2) in accordance with the articles of the corporation.
>
> **(4)** Where the articles of a membership corporation do not provide for the transfer of any remaining property of the corporation, on the dissolution of the corporation, the liquidator shall:
>
> (a) divide any remaining property of the corporation in equal shares according to the number of membership interests in the corporation on that day; and
>
> (b) distribute the shares rateably among the persons having the membership interests.
>
> **(5)** Where the articles of a charitable corporation provide for the transfer of the property of the corporation on dissolution to any of the following, the liquidator shall transfer any remaining property of the corporation, other than the property mentioned in subsection (2), in accordance with the articles:
>
> (a) a charitable corporation;
>
> (b) a registered charity within the meaning of the Income Tax Act (Canada);
>
> (c) a municipality;
>
> (d) the Government of Canada or a government of any province or an agency of any of those governments;
>
> (e) any combination of the bodies described in clauses (a) to (d).
>
> **(6)** Where the articles of a charitable corporation do not provide for the transfer of the property of the corporation on dissolution in accordance with subsection (5), the liquidator shall, subject to subsection (7), transfer any remaining property of the corporation, other than the property mentioned in subsection (2), to:
>
> *Continued*

remaining property among their members, with tax consequences, on dissolution.[257]

RECOMMENDATION 50

The new act should include provisions with respect to voluntary liquidation and dissolution, administrative dissolution and judicial dissolution. The act should require fully restricted corporations to distribute their net assets to qualified donees on dissolution; partly restricted corporations should have the ability to distribute remaining property to their members.

(a) a corporation carrying on the same or similar activities;

(b) a registered charity within the meaning of the Income Tax Act (Canada);

(c) a municipality;

(d) the Government of Canada or a government of any province; or

(e) any combination of the bodies described in clauses (a) to (d).

(7) A liquidator shall not transfer property of a charitable corporation pursuant to subsection (6) except in accordance with an order from the court obtained pursuant to section 201.

(8) Where a liquidator applies to a court pursuant to subsection (7), he or she shall give notice to the Director of the application, and the Director may appear and be heard in person or by counsel.

[257] See the *Asset Distribution* section above.

CHAPTER 7

Registration of Extra-provincial Corporations

ISSUE 17

Would it be useful to include registration provisions for extra-provincial non-profit corporations in the non-profit corporate legislation, rather than in the *Business Corporations Act*? (Recommendation 51)

[258] Section 279 of the BCA requires a corporation, including a non-profit corporation, that is incorporated in another jurisdiction but "carrying on business" in Alberta, to register in Alberta.[258] ALRI Report 49 explained the process and the purpose of registration as follows:[259]

> Registration involves providing the Registrar with the corporation's fundamental corporate information, and it also involves the appointment of an attorney in the province for service of documents upon the corporation. The purpose of registration is to give Albertans a place in the province where they can obtain basic information about a corporation and a place in the province where they can serve it with notices and legal process.

[259] Although the registration requirement applies to both for-profit and non-profit corporations, it is only found in the BCA. It is perhaps, therefore, not surprising that the number of non-profit corporations registering extra-provincially in Alberta is quite low. There are two possible explanations: (1) non-profit corporations may not be aware of the requirement to register extra-provincially as it is only found under the BCA, or (2) some corporations might register extra-provincially without identifying as non-profits.[260] In any event, to avoid any confusion, we think that the extra-provincial registration requirement

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[258] Section 277(1) of the BCA defines "carrying on business" broadly so as to include a corporation if: (a) its name is listed in a telephone directory in Alberta; (b) its name is in an advertisement with an Alberta address as a place of contact; (c) it has a resident agent, warehouse or office or place of business in Alberta; (d) it solicits business in Alberta; (e) it is the owner of any estate or interest in land in Alberta; (f) it is licensed or registered or required to be licensed or registered under any Act of Alberta entitling it to do business; (g) it is, in respect of a commercial vehicle as defined in the *Traffic Safety Act*, the holder of a certificate of registration under the *Traffic Safety Act*, unless it neither picks up nor delivers goods or passengers in Alberta; (h) it is the holder of a certificate as defined in section 130 of the *Traffic Safety Act*, unless it neither picks up nor delivers goods or passengers in Alberta; or (i) it otherwise carries on business in Alberta.

[259] ALRI Report 49, at 68.

[260] The latter explanation is unlikely, however, as the filing fee for registering extra-provincially as a non-profit is lower than that of a for-profit.

for non-profit corporations should be moved to the non-profit corporate legislation. The BCA would continue to specify the equivalent registration provision concerning for-profit corporations.

RECOMMENDATION 51

The new act should include a provision for the registration of extra-provincial non-profit corporations. Accompanying material concerning how to comply with the extra-provincial registration requirement would be useful.

CHAPTER 8

Corporate Remedies

ISSUE 18

What internal remedies are best suited for non-profit corporations? What external remedies are best? (Recommendations 52 to 59)

[260] Corporate remedies are means by which the rights and obligations of the participants in a corporation, for example, the corporation's directors, officers, members, employees or creditors, are satisfied or enforced. Thus, statutory remedies generally match those rights and obligations as set out in the incorporating statute or governing documents. A recent trend, however, seems to be to add to corporate remedies, especially shareholder-like remedies which typically involve court intervention.

[261] There is merit to having checks and balances to protect the various interests at stake in a corporation. However, when developing remedies for non-profit corporations, the competing interests of the entity as a whole should be balanced against the interests of the participants individually. While individual remedies may be needed to enforce member-specific rights, we think that it would be a mistake to move away from collective remedies as was done in some non-profit corporate statutes with the introduction of remedies such as the oppression remedy.

[262] Furthermore, in a sector where resources are often limited, precedence should also be given to remedies that tend to minimize the costs associated with resolving disputes, controversies or dissensions within the corporation. Therefore, we think that the new act should encourage non-profit corporations to implement internal remedies that fit their particular circumstances, taking into consideration such matters as their purpose of incorporation, their activities, the size and type of their membership, and the rights and expectations of their members.

RECOMMENDATION 52

Preference should be given to internal remedies over external remedies and to collective remedies over individual remedies.

A. Internal Remedies

[263] Generally speaking, non-profit corporate legislation provides for only a few internal remedies. However, there are several reasons why the new act should give preference to internal remedies over external remedies. Internal remedies are generally less costly and time-consuming, more flexible (e.g. if a mistake is made along the way, parties may self-correct after input from others), and often less disruptive for those not involved in the dispute.

1. REQUISITION OF MEETING AND VOTE

[264] A simple way to resolve internal corporate disputes is often to provide parties with a platform to exchange information and air their views. Although directors should generally be responsible for calling annual and special meetings, we think that the act should also allow members entitled to vote to require the directors to call a meeting of members, as long as that initiative is supported by a prescribed percentage of members (e.g. at least 10%).[261] The requisition should state the matter to be submitted and discussed at the meeting and be sent to all directors, officers and members of the corporation. If the directors refuse to call the meeting within a reasonable period after receiving the requisition, any member who signed the requisition should be allowed to call the meeting.[262]

RECOMMENDATION 53

The new act should provide that a percentage of the voting members prescribed in the act or regulations may require the directors to call a special meeting of members in an attempt to resolve any disputes or controversies arising out of the articles or by-laws, or other aspects of the operations of the corporation.

2. ARBITRATION AND MEDIATION

[265] Non-profit corporations can be encouraged – if not directed - to provide for dispute resolution processes in their by-laws. The *Societies Act* currently provides that:

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[261] The CNCA provides that members who hold at least 5% of the voting rights may require the directors to call a meeting of members. See CNCA, s 167; *Canada Not-for-profit Corporations Regulations*, SOR/2011-223, s 72(1).

[262] Another option is to encourage non-profit corporations to hold a regular consultation forum to involve the active membership.

> **22(1)** The bylaws of a society may provide that a dispute arising out of the affairs of the society and between any members of the society or between
>
> (a) a member or a person who is aggrieved and who has for not more than 6 months ceased to be a member, or
>
> (b) a person claiming through the member or aggrieved person or claiming under the bylaws of the society,
>
> and the society or a director or officer of the society, shall be decided by arbitration, which shall be under the *Arbitration Act* unless the bylaws prescribe some other method.
>
> **(2)** A decision made pursuant to an arbitration is binding on all parties and may be enforced on application to the Court of Queen's Bench, and unless the bylaws otherwise provide there is no appeal from it.

[266] Most Canadian non-profit corporate legislation does not include a provision concerning dispute resolution.[263] In its recent report on incorporated societies, the New Zealand Law Commission recommended that the statute should require societies to include procedures in their constitutions for resolving internal disputes. It left the mechanism up to each individual society to develop so long as certain basic requirements of natural justice, as defined in the statute, were met. In making these recommendations, it noted that larger, well-resourced societies may already have detailed dispute resolution provisions in place and that the smaller, less well-resourced societies might benefit from an example of a dispute resolution procedure in the model by-laws.[264]

[267] Possible dispute resolution mechanisms to settle disputes between participants in non-profit corporations include internal processes, mediation

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[263] See Yukon's *Societies Act*, RSY 2002, c 206, s 7(2)(l). The CNCA is silent on this issue, however, section 9 of the by-laws to the CNCA provides a detailed dispute resolution provision.

[264] New Zealand Law Commission, *A New Act for Incorporated Societies*, Report 129 (June 2013) at para 8.5:

> We do not envisage that all societies must have the same or similar procedures. We recommend that the new Act require that societies have rules or procedures for resolving disciplinary disputes and other grievances. The Act should contain minimum requirements for such rules, concentrating in particular on defining natural justice requirements for societies dealing with disputes. Some simple procedures that would satisfy the statutory minima may be set out in model rules, but each society remains free to develop or retain their own procedures, so long as they satisfy the statutory minima. Some larger, well-resourced societies, for instance sporting bodies, have well-developed dispute procedures, including access to external arbitral bodies. Such procedures will almost certainly satisfy the natural justice minima imposed by the new Act, and societies will be able to continue to use the processes and providers that they have already developed or chosen. Other societies that currently do not have procedures may choose to adopt mixtures of internal resolution, access to external mediation and appointing some form of external arbitrator or referee. The decision will rest with each society, so long as statutory minima are met.

and/or statutory arbitration.[265] These mechanisms provide an easier and less costly way to resolve disputes related to matters such as financial disclosure, member discipline and termination of membership. Unless it is ineffective or impractical to do so, parties are generally required to exhaust internal remedies before bringing their disputes to court.[266] However, arbitration decisions may be binding on the parties when so provided.[267]

[268] The new act should require corporations to set out internal dispute resolution mechanisms in their by-laws, and to settle any internal corporate disputes or grievances following the mandated processes, unless otherwise specified.[268] Corporations should be free to choose the mechanisms that are best suited to their particular needs and circumstances, as long as they meet the requirements of fairness and natural justice. The act should include a provision similar to that of the *Societies Act*. However, that provision should be stated as a default rather than as a discretionary option as is currently the case.

RECOMMENDATION 54

The new act should provide that disputes, dissension or controversies among directors, officers, or members of a corporation are settled through mediation and/or arbitration, unless otherwise provided. The dispute resolution procedures and requirements should be set out in the corporation's by-laws. The by-laws should also specify whether decisions are binding on the parties.

3. DISSENT AND APPRAISAL

[269] In the for-profit context, an appraisal remedy is the way by which corporate shareholders who dissent or oppose some important changes, for example a merger, may require that the corporation buy back their shares at the appraised value. The Saskatchewan Act includes a similar remedy for members of a membership corporation who are entitled to a share of any remaining

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[265] Generally speaking, there are three reference models for arbitration: (1) *Arbitration Act*, RSA 2000, c A-43; (2) *International Commercial Arbitration Act*, RSA 2000, c I-5; (3) Uniform Law Conference of Canada's *Uniform Arbitration Act*.

[266] *Alberta Soccer Association v Charpentier*, 2010 ABQB 715 at paras 27–32.

[267] Short of bad faith or procedural unfairness, a court will not intervene if the dispute resolution process is carried out in accordance with the by-laws.

[268] For example, the by-laws could specify that certain types of disputes, such as appraisal of membership interest, must be brought directly to court.

property on dissolution of the corporation.[269] The Act provides that a member of any class of members has the right to dissent if the corporation resolves to:

- amend its articles to allow for, or add, change or remove restrictions on, the transferability of membership interests of that class,
- amend its articles to add, change or remove any provisions restricting the activities that the corporation may carry on,
- amalgamate with another corporation,
- continue into another jurisdiction, or
- sell, lease or exchange all or substantially all its property.

This allows the dissenting member to receive the fair market value for his or her membership interest when the change from which the member dissents is undertaken.[270]

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[269] The Saskatchewan Act, s 177 provides that:

> **Right to dissent**
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> **177(1)** Subject to sections 182 and 225, a member of any class of members of a membership corporation who is entitled pursuant to subsection 209(3) or (4) to receive a share of any remaining property of the corporation on its liquidation and dissolution may dissent if the corporation is subject to an order pursuant to clause 183(4)(c) that affects the member or if the corporation resolves to:
>
> (a) amend its articles pursuant to section 161 to allow for the transferability of membership interests of that class, or add, change or remove restrictions on the transferability of membership interests of that class;
>
> (b) amend its articles pursuant to section 161 to add, change or remove any provisions restricting the activities that the corporation may carry on;
>
> (c) amalgamate with another corporation, otherwise than pursuant to section 171;
>
> (d) be continued pursuant to the laws of another jurisdiction pursuant to section 175; or
>
> (e) sell, lease or exchange all or substantially all its property pursuant to subsection 176(3).
>
> **(2)** A member of any class of members of a membership corporation who is entitled pursuant to subsection 209(3) or (4) to receive a share of any remaining property of the corporation on its liquidation or dissolution may dissent from an amendment to the articles effecting any change mentioned in subsection 163(1).
>
> **(3)** In addition to any other right he or she may have, but subject to sub-section 181(3), a member who complies with this section and sections 178 to 181 is entitled, when the action approved by the resolution from which he or she dissents or an order made pursuant to subsection 183(4) becomes effective, to be paid by the corporation the fair value of the membership interest held by the member with respect to which he or she dissents, determined as of the close of business on the day before the resolution was adopted or the order was made.
>
> **(4)** A dissenting member may only claim pursuant to this section and sections 178 to 181 respecting all the membership interests of a class held by him or her on behalf of any one beneficial owner and registered in the name of the dissenting member.

The ONCA, s 187 includes a similar remedy. Neither the ONCA nor the British Columbia's *Societies Act White Paper* provides for a right of dissent and appraisal: *Societies Act White Paper – August 2014*, note 16.

[270] Under the Saskatchewan Act, if a corporation fails to pay the value of the member's membership interest or the corporation and the member cannot agree on that value, the corporation or the member may apply to a court to fix a fair value for the membership interest: see Saskatchewan Act, s 180.

[270] The availability of such a remedy may be particularly important where members have significant financial interests in a corporation. Members who invest important amounts of money in exchange for an ownership stake in the assets of the corporation should have means to protect that investment when the actions of the majority changes the terms of their participation in the corporation in a substantial manner. The new act should provide that the members of an organization that elects to incorporate as a partly restricted corporation may oppose an amendment to the articles or a fundamental change and be paid the value of their membership interest when that action become effective, unless otherwise provided in the articles.

RECOMMENDATION 55

The new act should provide that members of a partly restricted corporation who dissent from amendments to the articles or specified fundamental changes are entitled to receive a payment for the fair market value of the membership interest they hold in the corporation, unless otherwise provided by the corporation's governing documents.

B. External Remedies

[271] Where internal remedies are not available or are exhausted, parties may want to bring their disputes to court. However, a court will not intervene in internal corporate disputes unless it has jurisdiction to do so. Corporate legislation usually provides a variety of readily available remedies by which a person may ask a court to enforce a right or to address a problem with a corporation.

[272] Most non-profit statutes already include mechanisms for annulment of contract for failure to disclose a conflict of interest, recovery of money improperly paid to a member or other recipient, review of election, court-supervised liquidation, and rectification of records.[271] A question that has attracted a lot of attention, however, is whether other remedies typically reserved for shareholders of for-profit corporations should also be made available to members of non-profit corporations.

[271] See, for example, CNCA, ss 141(10), 145(3), 169, 221(8) and 255. In addition, corporate legislation may sometimes give courts (or corporate authorities) the power to investigate or impose penalties.

1. DERIVATIVE ACTION

[273] As a separate entity, a corporation can sue and be sued. Generally, it is the responsibility of the board of directors – who control the decision-making – to pursue legal proceedings or defend lawsuits against the corporation. However, there may be situations where a board fails or refuses to take action. For example, it is unlikely that directors who inappropriately diverted funds would want to take any action that may result in legal proceedings against themselves. In such case, a claim for breach of fiduciary duty could be brought by way of derivative action.

[274] A derivative action is thus a recourse in which a complainant seeks leave to bring, or intervene in, an action in the name and on behalf of a corporation where the board of directors has failed to do so. The claim must be for a harm to the corporation. A derivative claim is not appropriate if the harm is to individual members, as opposed to the whole body of members.[272] Moreover, the complainant must satisfy a court that:

- reasonable efforts were made to cause the corporation's directors to pursue the matter,
- notice of the intention to initiate a derivative action was given to the corporation's directors,
- the complainant is acting in good faith, and
- the proposed derivative action is in the best interests of the corporation.

[275] The court has the authority to dismiss frivolous actions, for example, if a member or faction of members is using a derivative action to advance a claim that is not in the best interests of the corporation or otherwise disrupt the functioning of the organization. The court's analysis does not generally go

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[272] Harm to a corporation may also cause harm to its members. Such harm is not particular to a member or group of member but equally suffered by the collectivity. See Jeffrey MacIntosh, "The Oppression Remedy: Personal or Derivative" (1991) 70 Can Bar Rev 29, at 30-31:

> A derivative action is commonly said to arise where it is *the corporation* that is injured by the alleged wrongdoing. The "corporation" will be injured when all shareholders are affected equally, with none experiencing any special harm. By contrast, in a personal (or "direct") action, the harm has a differential impact on shareholders, whether the difference arises amongst members of different classes of shareholders or as between members of a single class. It has also been said that in a derivative action, the injury to shareholders is only *indirect*; that is, it arises only because the corporation is injured, and not otherwise.

beyond the legal rights of the parties as a derivative action is not, strictly speaking, an equitable remedy and requires proof of specific wrongdoing.[273]

[276] Most modern non-profit corporate statutes include a derivative action.[274] These statutes allow a complainant to pursue, with permission of a court, a legal proceeding on behalf of a corporation. The term "complainant" is usually defined broadly. For example, the CNCA defines complainant as including a former or present member or debt obligation holder of a corporation or any of its affiliates, a present or former registered holder or beneficial owner of a share of an affiliate of a corporation, a former or present director or officer of a corporation or any of its affiliates, the Director, or any other person who, in the discretion of a court, is a proper person to make such application.[275]

[277] The inclusion of a derivative action in non-profit legislation may be beneficial in that it offers an alternate way to address concerns with the conduct of a corporation or the actions of its directors. For example, it may be particularly useful to enforce fiduciary duties owed to the corporation where directors may be less likely to do so. However, additional safeguards should be put in place to prevent misuse of the derivative action.[276] To this end, we think that only those with a stake in the governance of a corporation, that is, directors, officers and members, should be legislatively entitled to apply to court for leave to bring a derivative action. In the case of the members, the application should be supported by a certain percentage of members (e.g. at least 20%). This requirement not only reinforces the distinction between derivative and personal claims, but is also in line with the idea of giving preference to collective remedies.

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[273] In contract to an oppression remedy, a derivative action is not based on equity consideration, that is, whether a reasonable expectation of the complainant has been violated in an oppressive or unfairly prejudicial manner, but on evidence of legal wrong.

[274] See Saskatchewan Act, s 223; ONCA, s 183; CNCA, s 251. British Colombia has also recommended the inclusion of a derivative action in the *Societies Act*: see *Societies Act White Paper- August 2014*, note 16 at 63-64.

[275] CNCA, s 250

[276] Both the ONCA and the CNCA restrict the use of a derivative action to non-religious corporations to avoid the possibility of a member using that remedy to challenge the doctrine of a religious organization. For example, the CNCA, s 251(3) provides that:

> **Faith-based defence**
>
> **251(3)** The court may not make an order under subsection (1) if the court is satisfied that
>
> (a) the corporation is a religious corporation;
>
> (b) the decision of the directors referred to in paragraph (2)(a) is based on a tenet of faith held by the members of the corporation; and
>
> (c) it was reasonable to base the decision on a tenet of faith, having regard to the activities of the corporation.

[278] The new act should provide that a director, officer or a prescribed percentage of voting members of a corporation, may apply to a court for an order granting them leave to bring an action on behalf of the corporation, or to intervene in an action to which the corporation is a party, for the purpose of prosecuting, defending or discontinuing the action on its behalf. Accompanying materials should explain the purpose and requirements of the derivative action, as well as its limitations.

RECOMMENDATION 56

The new act should provide that a director, officer or a percentage of the voting members prescribed in the act or regulations may apply to a court for an order granting them leave to bring a derivative action in the name of or on behalf of the corporation.

2. COMPLIANCE OR RESTRAINING ORDER

[279] A corporation must act in accordance with the incorporating statute and governing documents. Consequently, corporate legislation often includes a remedy which gives a court jurisdiction to direct a corporation – or any director, officer, employee, agent, auditor, trustee, receiver, receiver-manager or liquidator of a corporation – to comply with or restrain from contravening a provision of the act, regulations, articles or by-laws of the corporation.[277] For example, this means that a court may order a corporation to call an annual or special meeting of members, or to give access to corporate records.

[280] As previously discussed, when people have rights, they should also have remedies to enforce those rights if needed. Non-profit corporations should be encouraged to provide internal remedies to resolve this type of issues. However, such internal remedies are not always available or may simply fail. For that reason, we think that the new act should include a provision allowing any person with entitlements under the act or governing documents, including a director, officer or member, but also an agent, employee or creditor of the corporation, to apply for a compliance or restraining order.

[277] See Saskatchewan Act, s 231; ONCA, s 191; CNCA, s 259.

RECOMMENDATION 57

The new act should provide that a present or former director, officer or member, or any other person whom a court considers entitled under the act or governing documents, may apply to the court for an order directing the corporation to comply with, or restraining it from acting in breach of, the act, regulations or governing documents.

3. OPPRESSION REMEDY

[281] Corporate legislation establishes "off the rack" rules for the conduct of a corporation; the articles and by-laws of a corporation may amend or supplement those statutory rules. Together the incorporating statute and governing documents try to provide for all reasonably foreseeable contingencies in the life of corporations (e.g. rules for calling of meetings, voting and quorums, rules for amalgamation, continuance and dissolution, etc.). Because of unanticipated issues or changed circumstances, however, there are bound to be gaps in standard rules. Simply to leave such gaps to be filled by unconstrained majority decision-making may expose the participants in a corporation to potential abuse.

[282] Minority shareholders of close corporations are particularly vulnerable to majority misconduct. In the for-profit context, this may be explained by at least three factors: (1) the practical difficulties of pursuing a claim against the majority, (2) the primacy of the majority rule and the business judgment rule, and (3) the illiquidity of the shareholders' investment. Thus, an oppression remedy was developed to protect minority shareholders from oppressive or unfair conduct by the majority.

[283] But what makes internal corporate conduct oppressive or unfair? In *Elder v Elder & Watson Ltd*, Lord Cooper stated that "the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely".[278]

[284] In assessing oppression claims, a court's primary consideration is whether a reasonable expectation of the complainant has been violated in an oppressive or unfairly prejudicial manner. In that sense, the oppression remedy is an equitable remedy, which gives courts the jurisdiction to go beyond mere legal

[278] *Elder v Elder & Watson Ltd*, [1952] SC 49, at 55 [Ct Sess].

rights of the parties and consider what is fair and equitable among them based on their reasonable expectations in the given circumstances.[279]

[285] Courts also have the discretion to make any order they see fit to provide relief to complainants where liability has been found. However, in most oppression cases, courts choose to order a buy-out of the complainant's interest in the corporation, which permits the corporation to carry on and the shareholder to take out his or her investment and move on.

[286] For-profit corporate statutes – and two non-profit ones – have slightly extended the scope of the oppression remedy.[280] For example, the CNCA provides that a court may make any order it considers appropriate if satisfied that an act, omission or conduct of a corporation, or the exercise of the powers of its directors or officers, "is oppressive or unfairly prejudicial to or unfairly disregards the interests of any shareholder, creditor, director, officer or member, or causes such a result".[281]

[287] One of the main problems with the inclusion of an oppression remedy in non-profit legislation is that many stakeholders do not have the sort of financial interest or contractual relationship that typically warrant a recourse to that remedy. For that reason, some have suggested that the legislation should leave it up to individual corporations to decide whether their articles or by-laws should include a provision that gives members the ability to pursue an oppression

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[279] For example, in *Ebrahimi v Westbourne Galleries Ltd* [1972] 2 All ER 492 (HL), two shareholders of a three shareholder corporation combine to exclude the third from management. Although this removal was legal, the court decided that the position in which the excluded shareholder found himself looked in, that is, out of management with no access to profits of the business which were distributed in the form of management remuneration, was inconsistent with the legitimate expectations he had when he became involved in the business.

[280] See Saskatchewan Act, s 225; CNCA, s 253. It should be noted that the CNCA also includes a faith-based defence for religious corporations. The British Columbia's *Societies Act White Paper – August 2014*, note 16 at 62 recommends the inclusion of a provision similar to an oppression remedy. The CNCA does not provides for such remedy.

[281] CNCA, s 253(1). The Saskatchewan Act, s 225(1) even goes further by providing that:

> Application to court re oppression
>
> **225(1)** A complainant may apply to the court for an order pursuant to this section and the court may make an order to rectify the matters complained of where the court is satisfied that the result of any act or omission of the corporation or any of its affiliates, the manner in which any of the activities or affairs of the corporation or any of its affiliates are or have been carried on or conducted, or the manner in which the powers of the directors of the corporation or any of its affiliates are or have been exercised:
>
> (a) is oppressive or unfairly prejudicial to any member, security holder, creditor, director or officer or, where the corporation is a charitable corporation, *the public generally*; or
>
> (b) unfairly disregards the interests of any member, security holder, creditor, director or officer or, where the corporation is a charitable corporation, *the public generally*. [emphasis added]

remedy.[282] Although this may seem an attractive proposition, we doubt that a provision of the articles or by-laws, which are ultimately private agreements, can independently create a right to apply to court for an oppression order.

[288] The question therefore remains: should the new act include an oppression remedy? On balance, we do not think that the issues that the oppression remedy seeks to address necessarily translate to the non-profit context. The few situations where oppressive or unfair actions of non-profit corporations may result in direct financial losses for individual stakeholders do not justify the inclusion of a remedy that could be used to tie corporations up in complex, expensive and time-consuming court challenges. Furthermore, as previously discussed, there are more appropriate remedies to protect the various interests at stake, including dispute resolution, dissent and appraisal, and compliance or restraining orders.[283]

RECOMMENDATION 58

The act should not allow applications for an oppression remedy by individual complainants.

4. APPLICATION FOR DISSOLUTION BY COURT ORDER

[289] Pursuant to the interaction between the *Societies Act* and the BCA, a member may apply for court-ordered liquidation and dissolution. Currently, a court has jurisdiction to liquidate and dissolve a society if it is satisfied that certain grounds exist, including:[284]

- the act, omission or conduct of the society is oppressive or unfair to any security holder, creditor, director or officer,

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[282] See Industry Canada, Policy Sector, Corporate and Insolvency Law Policy Directorate, *Reform of the Canada Corporations Act: Discussion Issues for a New Not-for-Profit Corporations Act*, March 2002, at 37–38, available online at: <www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/optionfinal_en_ed.pdf/$FILE/optionfinal_en_ed.pdf>.

[283] It should also be noted that in addition to corporate remedies, the creditors, directors, officers and members of a corporation have access to common law and statutory remedies, such as those provided by bankruptcy and insolvency, fraudulent conveyance and preference, or labor and employment law.

[284] In *Hull Ltd v Bean Services Inc*, 2013 BCSC 1208 at para 57, Gropper J. gave examples of situations where it may be just and equitable to order the liquidation and dissolution of a corporation:

> ... Although the discretion to grant relief under s. 324 cannot be restricted to pigeon hole categories, the following grounds are commonly relied upon to justify judicial intervention: (1) where there is a loss of substratum; (2) where there exists a justifiable lack of confidence among the members; (3) where the parties are in deadlock; and (4) where the partnership analogy applies.

- the constitution of the society provides for dissolution upon the occurrence of a particular event, and that event has occurred, or
- it is just and equitable that the society should be liquidated and dissolved.

The Saskatchewan Act, CNCA and ONCA include a similar remedy.[285]

[290] Court-ordered liquidation and dissolution on application of an individual is a drastic remedy of last resort. Even in situations where minority shareholders find themselves locked in as shareholders with no access to the management or profits of the business, courts will not order winding up unless there is no other practical way to protect the financial interest of those shareholders.

[291] There are generally easier ways to "escape" from unresolved disputes in a non-profit corporation. In most cases, disgruntled members may simply walk away.[286] While walking away may not be an option for members who have made a significant investment in exchange for an ownership interest in the corporation, they may have the right to dissent and be paid the fair market value for their membership interest by the corporation, or sell their membership on the market.[287]

[292] However, an organization may become so caught up in internal disputes that the only solution is a winding-up. As previously discussed, the members of a corporation may agree by special resolution to proceed with a proposal to liquidate and dissolve the corporation. The ability for a member to pre-empt this democratic process by applying to court for a liquidation and dissolution order seems inconsistent with the very nature of a body corporate created for public benefit or mutual benefit of its members. We think that the decision to wind-up a non-profit corporation should be the result of a collective choice, not an individual initiative.[288]

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[285] See Saskatchewan Act, s 198; ONCA, s 136; CNCA, s 224. A faith-based defence is generally available to religious corporations. British Colombia has also recommended the inclusion of a provision that will allow court-ordered liquidation and dissolution on application by the society, a member or director, or any other person whom the court considers to be an appropriate person to make an application: see *Societies Act White Paper – August 2014*, note 16 at 78.

[286] *Latin American Senior Citizens Cultural Association of Edmonton v Govea*, 2014 ABQB 72 at para 20.

[287] Under the proposed "two-part model", members of a partly restricted corporation may have both the option to be paid the fair market value of their membership by the corporation, or to sell their membership on the market. See discussion in the *Asset Distribution* and *Termination of Membership* sections above.

[288] This does not preclude administrative or judicial dissolution for failure to comply with the requirements of the incorporation statute. Corporate legislation generally provides that a court can order the involuntary

Continued

RECOMMENDATION 59

The new act should not allow a court application for liquidation and dissolution by individual members. The grounds for court-ordered liquidation and dissolution should be limited to failure to comply with specified requirements as defined in the act or regulations.

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dissolution of a corporation for contravening certain requirements of the incorporating statute, such as not holding annual meetings of members; carrying on activities or exercising powers in a manner not permitted by the articles; not providing members access to corporate records; not keeping a copy of the financial statements at the corporation's registered office; not sending a copy or summary of the financial statements to the members (unless otherwise provided by the by-laws); or procuring any certificate under the act by misrepresentation. The corporate authorities or any interested person may apply to a court for an order liquidating and dissolving a corporation. See discussion in the *Fundamental Changes* section above.

CHAPTER 9

Transitional Issues

ISSUE 19

What would be a workable transitional arrangement for a new non-profit corporate legislation? (Recommendations 60 to 62)

[293] Transitional arrangements are important to the successful implementation of any new non-profit corporate legislation. A number of sub-issues related to any transitional arrangement are discussed below: (1) How should reformed non-profit corporate legislation apply to existing societies and Part 9 companies? (2) What transitional period would be appropriate? (3) What resources should be made available?

A. Existing Societies and Part 9 Companies

[294] The first sub-issue concerns how any new non-profit corporate legislation should apply to existing societies incorporated under the *Societies Act* and to companies incorporated under Part 9 of the *Companies Act*. Should it be mandatory for existing societies and companies to re-register under the new legislation or should this be optional? The primary reason for a mandatory approach is that existing corporations will get the benefit of the reformed provisions. If a mandatory approach is adopted, what should be the consequences of failing to re-register? Dissolution, deemed conformity or other?

[295] Canadian jurisdictions that have recently reformed their non-profit corporate legislation have adopted a mandatory approach. However, the consequences of failing to register differ greatly depending on the legislation. For example, the federal and Ontario governments have taken very different approaches to transition under their respective non-profit incorporation legislation.

[296] Under the federal regime, corporations already incorporated under the CCA do not incorporate again under the CNCA. Instead, they can "continue" under the CNCA and are issued a certificate of continuance instead of a certificate of incorporation. However, to obtain a certificate of continuance, existing corporations have to apply and file new organizational documents that

comply with the CNCA within the prescribed transition period.[289] The rules under the CCA (and the existing letters patent, supplementary letters patent, if any, and by-laws) apply until a certificate of continuance is issued. The CNCA provides that if an existing corporation is not continued under the CNCA before the prescribed deadline, it may be dissolved by Corporations Canada. A dissolved corporation would, however, be able to apply for revival under the CNCA.

[297] In contrast, under the ONCA, there will be an automatic continuance of corporations without share capital already incorporated in Ontario. This means that once the ONCA is in force, it will immediately apply to existing corporations. Corporations will still need to bring their governing documents into conformity with the Act. However, if corporations do not do so within the prescribed transition period, the ONCA will deem the governing documents to be amended to the extent necessary to conform to the requirements of the ONCA.[290] Any provision of the governing documents that conflicts with the ONCA will become ineffective after the three-year transition period.[291]

[298] We think that the CNCA's approach is preferable to that of the ONCA. Requiring corporations to take positive steps to ensure full compliance in order to continue in the new act provides an opportunity for the corporations to review and revise their governing documents. It also promotes greater awareness and understanding of the key changes coming under the legislation. The corporate authorities' power to dissolve corporations that do not transition within the

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[289] In order to apply for a certificate of continuance, a corporation must replace its letters patent, supplementary letters patent (if any) and by-laws. The articles and by-laws must comply with the CNCA. A corporation had until October 17, 2014 to continue under the CNCA.

[290] Newly formed corporations will have 60 days after formation to approve by-laws that conform with the ONCA, otherwise the Minister's template by-laws will apply.

[291] ONCA, s 207. There is some concern that confusion could arise from inconsistencies between the corporation's Letters Patent and by-laws, documents the directors, members and staff are most likely to go to for guidance or work with, and the deemed amendments required by the Act. See for example, Kate Lazier, Charities and Not-for-Profit Newsletter, "Transition Under the Ontario *Not-for-Profit Corporations Act, 2010*" (April 2012), available online at: <www.millerthomson.com/en/publications/newsletters/charities-and-not-for-profit-newsletter/2012_archives/april-2012/transition-under-the-ontario-not-for-profit>; David CK Tang, Newsletter, "Ontario New *Not-for-Profit Corporations Act 2010* (Bill 65) - 2013 Updates and Analysis of the Transition Provisions", (April 2013), available online at: <www.gowlings.com/KnowledgeCentre/article.asp?pubID=2896>. David CK Tang notes that:

> A provision of an existing by-law "remaining valid" is not the same as that provision overriding or eliminating a new right which the Act provides to non-voting members when that Act comes into force. The transition provision, section 207 of the Act, simply says that a non-conforming by-law is deemed to comply on the third anniversary of the Act coming into force. Section 207 does not say that the by-law should be interpreted as if Bill 65 did not exist until the third anniversary unless it is amended earlier. The Act does not explicitly postpone the effect of any provisions of the Act which are contrary to the intent of the existing constating documents.

prescribed period may also help to "weed out" organizations that are no longer active.

RECOMMENDATION 60

It should be mandatory for existing societies and companies to continue under the new act. The act should provide that failure to apply for a certificate of continuance within the period prescribed by the act or the regulations may result in the corporation's dissolution by the corporate authorities. A dissolved corporation should be allowed to apply for revival under the new act.

B. Transitional Period

[299] Typically, where existing non-profit corporations are required to continue under new legislation, a transitional period is provided to allow these organizations time to understand and comply with the requirements of the new act. If Alberta opts for a transitional approach similar to the CNCA, the act will not automatically apply to existing corporations. Corporations will have to take many steps to continue under and make the transition to the new act, including:[292]

- getting acquainted with the requirements of the new act,
- preparing the articles of continuance,
- adjusting existing by-laws or drafting new by-laws that comply with the act,
- holding a meeting of members to discuss and approve articles of continuance and by-laws, and
- applying for a certificate of continuance.

[300] Thus, the transitional period must give existing corporations enough time to go through all the steps of the transition process. Both the CNCA and ONCA give existing corporations a three-year transitional period within which to apply

[292] To obtain a certificate of continuance, the corporation must submit articles of continuance, along with the notice of directors and the notice of registered office forms. Generally, the by-laws do not have to be filed to obtain a certificate of continuance (the CNCA requires that they be filed within 12 months after members have approved them). However, the by-laws typically come into effect on the date that the corporation continues under the new act, not the date they are filed with the corporate authorities.

for a certificate of continuance.[293] The same transitional period was also used in Alberta regarding for-profit companies registered under the *Companies Act* who were required to continue under the BCA.[294]

[301] A further question is whether the transitional period should be the same for all provisions of the non-profit corporate legislation or for all classifications of non-profit corporations? For example, an earlier draft of the ONCA provided that those non-profit corporations that were "predominately social in nature" would have five years to bring themselves into compliance with the Act.

[302] While new corporations should be subject to the new act right away, we think that existing corporations should have at least a three-year period to address any substantial differences between old and new acts and make necessary adjustments to their governing documents. As previously mentioned, the corporate authorities should have the power to dissolve a corporation that has failed to take the necessary steps to continue under the new act within the transitional period, but dissolution should not be automatic. The wording of the transitional provision should be sufficiently permissive to allow the corporate authorities some discretion in this regard.

RECOMMENDATION 61

Existing corporations should have a three-year transitional period to adapt their governing documents to the new legislative requirements.

C. Resources

[303] If the decision is made that existing societies and Part 9 companies should be continued under the new legislation, then an important sub-issue is how to minimize the costs? What resources should be made available to these organizations during the transitional period?

[304] Under both the ONCA and the CNCA, transitional materials recommend that existing non-profit corporations obtain legal advice to review their

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[293] CNCA, s 297(5)–(6).

[294] The BCLI Report recommends a 2 year transitional period (the same period of time that was used in B.C. to transition for-profit corporations from the *Companies Act* to the *Business Corporations Act*). BCLI recommends that within the two-year transitional period, a pre-existing society must file the transition application (which includes a constitution) and alter its by-laws to the extent required. See BCLI Report at 21.

constitutive documents to ensure they are consistent with the new legislation. This can be a costly endeavour for smaller non-profit corporations.

[305] Resources are not the sole responsibility of the government; the legal community and also the non-profit sector have to be involved. In addition, those stakeholders need to work jointly to develop transitional materials and communication strategies well ahead of the coming into force of the new legislation. Umbrella organizations, such as the Muttart Foundation, Max Bell Foundation, Edmonton Chamber of Voluntary Organizations, Calgary Chamber of Voluntary Organizations, and Volunteer Alberta, are critical in getting the word out to the grassroots.

[306] At minimum, accompanying materials should indicate the areas of changes and steps to make the necessary adjustments. For example, corporations with share capital, such as golf clubs, should be instructed to establish the terms and conditions on which they are converted to a corporation without share capital (e.g. conversion from share certificate to membership certificate, membership transfer and fees and asset distribution on terminal dissolution).

[307] As previously mentioned, we think that standard form or model by-laws would also be of assistance in this regard. Efforts should also be made to mobilize umbrella organizations in the non-profit sector and *pro bono* services in the legal community to assist corporations with the transition to the new legislation.

[308] It should also be noted that under the *Income Tax Act*, there is a requirement to re-register when there is a change in corporate form. Industry Canada reached a deal with CRA, such that where there is a continuity of purpose, the CRA would not require re-registration for organizations transitioning to the CNCA. A similar parallel process would be desirable for Alberta.

RECOMMENDATION 62

Accompanying materials should clearly identify the key areas of changes. Model by-laws may also be useful.

Deadline for comments on the issues raised in this document is May 1, 2015