

NOT-FOR-PROFIT ORGANIZATIONS

Director Alert

The New Ontario Not-for-Profit Corporations Act – questions for directors to ask

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ARE YOU A DIRECTOR OF AN ONTARIO INCORPORATED CHARITY OR NOT-FOR-PROFIT?

IF SO, DO YOU KNOW THAT THE CORPORATE LEGISLATION WHICH GOVERNS THAT CHARITY OR NOT-FOR-PROFIT IS IN THE PROCESS OF BEING CHANGED AND THAT THE CORPORATION MAY NEED TO TAKE STEPS TO CHANGE ITS GOVERNANCE STRUCTURE?

I. Introduction

The new Ontario *Not-for-Profit Corporations Act, 2010*² (the “**ONCA**”) provides for the repeal of the *Corporations Act* (Ontario)³ (the “**OCA**”) and, specifically, will replace Part III of the OCA, the section which governs Ontario corporations without share capital (commonly referred to as not-for-profit corporations). The ONCA received Royal Assent on October 25, 2010 but has not yet been proclaimed in force. The Regulations to the ONCA are still being developed and, at the date of writing, are not yet publicly available. Proclamation was initially expected to occur on January 1, 2013 but was delayed to July 1, 2013. On March 28, 2013, the Ontario Ministry of Consumer Services (the “**Ministry**”) announced that the new target date for proclamation is January 2014 at the earliest.

Unlike its federal counterpart,⁴ once the ONCA is proclaimed, it will apply immediately to every Ontario not-for-profit corporation (including charities) currently governed by Part III of the OCA without the need for any further action by a corporation. However, any provisions in an Ontario not-for-profit corporation’s governing documents which are contradictory to the ONCA will continue to apply for three years. Once the transition period is over, the provisions of the ONCA will prevail and any language in the governing documents which is inconsistent with the ONCA will be deemed to have been amended to comply with the ONCA. Therefore, if a not-for-profit corporation does not amend its incorporating documents and by-laws to conform to the ONCA, they may not reflect the actual rules governing the corporation.

Further, the ONCA contains different requirements from the OCA regarding the provisions that must appear in incorporation documents. As such, while a not-for-profit corporation’s governing documents may not conflict with the ONCA because they do not address the new requirements, it may be unclear which provisions are deemed to

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² S.O. 2010, c. 15.

³ R.S.O. 1990, c. C.38.

⁴ The *Canada Not-for-profit Corporations Act*, S.C. 2009, c.23.

be amended under the ONCA. Since the ONCA will apply immediately upon proclamation, a corporation may find itself subject to certain undesirable governance requirements which may be harder to change under the ONCA than under the OCA.

Action Items:	Review and amend letters patent – requirements under the ONCA are different from the requirements under the OCA. Should any changes be made prior to proclamation of the ONCA?
	Review and amend by-laws – requirements under the ONCA are different from the requirements under the OCA. Should any changes be made prior to proclamation of the ONCA?
	Be proactive – take immediate steps to determine the necessary and desirable changes to your corporation's governance structure

Some of the issues that directors of Ontario not-for-profit corporations will need to consider when transitioning to the ONCA are discussed in this Director Alert.

II. Members and Membership Rights

The ONCA changes some of the rules regarding members and memberships rights. For example, **the new legislation grants voting rights to non-voting members in certain circumstances**. Specifically, the ONCA provides that where a proposed amendment to articles will affect a particular class of members, the amendment must be approved by that class by way of a separate class vote. This voting right is granted to both voting and non-voting members and a corporation may not opt out except in limited circumstances.

Having non-voting members does not contradict the OCA and therefore, it is unclear whether these members will have voting rights upon proclamation of the ONCA or after the three year transition period. If non-voting members will have voting rights immediately, then their approval will be required, separately by class, to remove them. That being said, the Ministry has stated that "it is the government's intent" that non-voting members will not have voting rights during the three-year transition period unless amendments are made to a corporation's governing documents to bring it into conformity with the ONCA during that period.⁵

In addition, the ONCA changes the requirements regarding the placement of membership provisions in a corporation's governance documents (although it does not mandate that articles of amendment be filed to include the required clauses). Some provisions must be contained in the articles and others in the by-laws:

Articles:	Classes of members
	Voting rights of each class if more than one class
	Whether a separate class vote is withdrawn (permitted only in certain circumstances)
By-laws:	Condition required for being a member in each class
	Process by which a member may withdraw or transfer to another class
	Conditions under which a membership can be terminated
Articles or By-laws:	Whether membership is transferable (default rule is that membership is not transferable unless specified to be transferable in the articles or by-laws)

⁵ <http://www.sse.gov.on.ca/mcs/en/Pages/onca3.aspx>.

Questions for Directors

•	Should the corporation's articles and by-laws be amended to contain the required information regarding membership classes?
•	Does the corporation currently have one or more classes of non-voting members? If so, will these members remain non-voting members and be permitted to vote in the circumstances specified in the ONCA or should they be reclassified as something other than members prior to or after proclamation of the ONCA?
•	Should the corporation, through its articles, opt out of class voting in the circumstances permitted by the ONCA?
•	Will membership interests be transferable or non-transferable? If transferable, will it be reflected in the article or the by-laws?

III. Directors

In addition, some of the rules regarding directors have changed. For example, the ONCA provides that the directors may appoint additional directors in between annual meetings of members. The number of directors appointed by the directors may not be more than one-third of the number of directors elected at the previous annual meeting and any directors so appointed may only hold office until the next annual members' meeting. Note that this power of appointment does not pertain to the filling of vacancies but to the ability to appoint directors over and above those elected by the members.

Appointment:	The directors may appoint additional directors in between annual meetings of members
Nominations:	Nominations are entitled to be by proposals submitted by members for the election of directors in advance of the meeting
Qualifications:	Directors will no longer be required to be members
Number:	Corporations will be able to have a floating number of directors (that is, a minimum and maximum number) rather than a fixed number ⁶
Removal:	The members may remove a director by ordinary resolution (that is, majority vote) and the threshold may not be increased

Questions for Directors

•	Should the by-laws address the process for directors appointing additional directors in between annual meetings?
•	Does the corporation's nomination process contemplate nominations received through member proposals in advance of meetings?

⁶ Practically speaking, this change will not have any significant impact because the number of directors will need to be fixed by the members, by special resolution, or by the directors (if authorized by special resolution of the members).

IV. Public Benefit vs. Non-Public Benefit Corporation

Under the ONCA, each not-for-profit corporation will be classified as either a public benefit corporation (a “PBC”) or a non-PBC. All charitable corporations will be PBCs as will some non-charitable, not-for-profit corporations that receive annual contributions of more than \$10,000, whether by donation or government grant. Specifically, a corporation will qualify as a PBC if it meets the criteria in any one of the boxes in the left-hand column below:

Public Benefit Corporation	Non-Public Benefit Corporation
A charitable corporation, that is, a corporation incorporated for the relief of poverty, the advancement of education, the advancement of religion or other charitable purpose (whether or not registered as a charity under the <i>Income Tax Act</i> (Canada) ⁷); or	
A non-charitable corporation that receives more than \$10,000 in a financial year from a public donor, that is, a person <u>who is not</u> , a member, director, officer or employee of the corporation; or	A non-charitable corporation that receives more than \$10,000 in a financial year from a person <u>who is</u> a member, director, officer or employee of the corporation; or
A non-charitable corporation that receives more than \$10,000 in a financial year by way of grant or similar financial assistance from a government or a government agency	A non-charitable corporation that receives \$10,000 or less in a financial year from any source

A PBC will need to determine annually whether or not it meets the criteria for a PBC. The test must be applied on the last day of the corporation’s financial year and if the corporation meets the criteria, it will become a PBC as of the next annual members’ meeting. A PBC will retain this status until the next annual meeting of members following the meeting at which it became a PBC, that is to say, a PBC will remain a PBC for approximately one year from the date it obtains such status. If, however, a corporation receives funds meeting the above criteria in the year that it is a PBC, the one year period will begin anew at the next annual meeting. Since the test is an annual one, a not-for-profit corporation’s status may alternate between being a PBC and not being one from one year to the next.

Specific provisions of the ONCA will apply depending on whether a not-for-profit corporation is classified as a PBC or not and directors of Ontario not-for-profit corporations must be aware of the designation and the resulting consequences. In particular, a PBC will be subject to additional requirements such as the following:

⁷ R.S.C., 1985, c. 1 (5th Supp).

	Public Benefit Corporation	Non-Public Benefit Corporation
Number of directors:	At least one-third of the directors must not be employees of the corporation or its affiliates ⁸	There are no restrictions on the employment status of their directors
Dissolution:	The remaining property of a charitable PBC must be distributed to a charitable corporation with similar purposes to its own or to a government or government agency whereas a non-charitable PBC will be required to distribute its remaining assets to another PBC with similar purposes to its own or to a government or government agency – a PBC may not distribute its remaining property to its members	No restrictions ⁹
Financial Disclosure and Review	See Part V below	See Part V below

Questions for Directors

• Is the corporation a charitable corporation?
• How much money does the corporation anticipate that it will receive from public donors and government?
• Is the corporation likely to be classified as a PBC in more years than not?
• Are any of the directors employees of the corporation or any of its affiliates and if so, how many?
• What would be the consequences to a non-PBC of being reclassified as a PBC?
• Knowing the consequences of reclassification, should the corporation continuously adhere to the rules governing PBCs or alter its governance structure and documents as needed depending upon its annual classification?
• Does the corporation need to change the dissolution clause in its letters patent and/or by-laws?

⁸ Note that under the common law employees of a charity may not be directors of the charity because directors of a charity may not receive remuneration from the charity, whether for acting as a director or for any other reason, without court approval.

⁹ Note that there may be tax implications if remaining property of a not-for-profit corporation is distributed to its members.

V. Financial Disclosure and Review

Under the ONCA, the default rule is that each not-for-profit corporation must have an audit in respect of its financial year although the members may pass an extraordinary resolution to have a review engagement instead of an audit or to not have an audit or a review engagement, in either case based upon the annual revenue of the corporation for the financial year and depending upon the classification of a corporation as a PBC or a non-PBC.

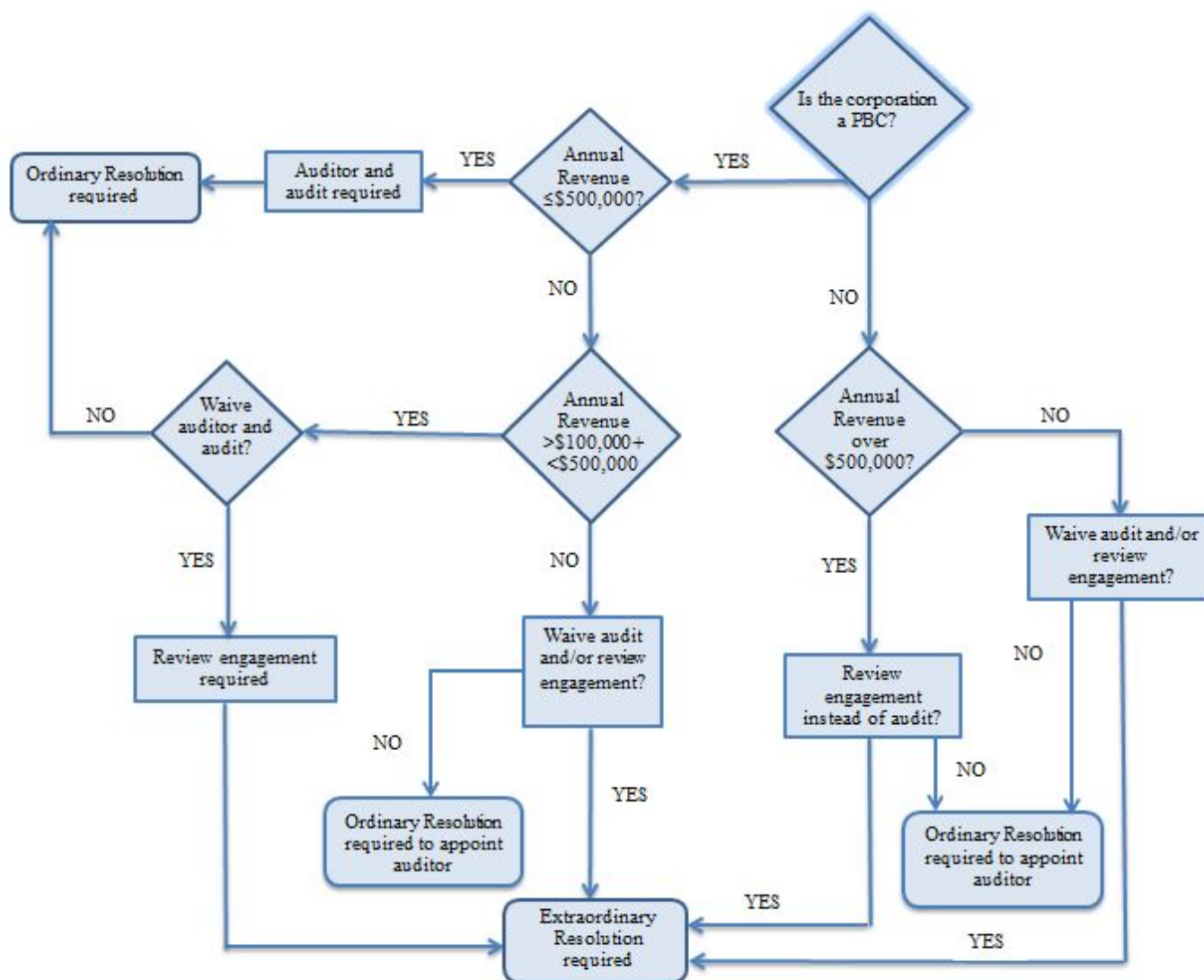
An extraordinary resolution is defined in the ONCA as a resolution passed by at least 80 percent of the votes cast by the members at a special meeting called for the purpose of considering the resolution or a resolution consented to by each member of the corporation entitled to vote at such a meeting.

Unless members have chosen not to appoint an auditor by extraordinary resolution, at each annual meeting, the members of a not-for-profit corporation must appoint, by ordinary resolution (that is, by majority vote) either an auditor to hold office until the close of the next annual meeting or a person to conduct a review engagement. The person so appointed must meet two criteria, namely, be “permitted to conduct an audit or review engagement of the corporation under the *Public Accounting Act, 2004*” and be “independent of the corporation, any of its affiliates, and the directors and officers of the corporation and its affiliates.”

The financial criteria and the options available to the members are set out below:

	Public Benefit Corporation			Non-Public Benefit Corporation	
Annual revenue for last financial year	\$500,000 or more	> \$100,000 and < \$500,000	\$100,000 or less	More than \$500,000	\$500,000 or less
Auditor	Must appoint an auditor	May appoint person to conduct review engagement instead of auditor by extraordinary members' resolution – valid until next AGM	May dispense with appointment of auditor by extraordinary members' resolution – valid until next AGM	May appoint person to conduct review engagement instead of auditor by extraordinary members' resolution – valid until next AGM	May dispense with appointment of auditor by extraordinary members' resolution – valid until next AGM
Level of financial review	Must have an audit	May have review engagement instead of audit by extraordinary members' resolution – valid until next AGM	May dispense with audit and review engagement by extraordinary members' resolution – valid until next AGM	May have review engagement instead of audit by extraordinary members' resolution – valid until next AGM	May dispense with audit and review engagement by extraordinary members' resolution – valid until next AGM

Questions for Directors



VI. Minimalist vs. Comprehensive By-Laws

Under the current regime, most not-for-profit corporations have lengthy by-laws essentially compensating for the gaps in the details contained in the OCA. The ONCA, however, provides a much more comprehensive set of rules governing not-for-profit corporations. As a result, ONCA corporations will be able to choose between long, detailed by-laws or minimalist by-laws which include only the information that is required and any alternatives to default rules.

Minimalist by-laws would be much shorter but should be accompanied by governance policies to address procedures that are not spelled out in the by-laws. Typically, policies only require director approval which should expedite their approval and amendment, as necessary. The downside of using minimalist by-laws is that corporations will need to become familiar with the lengthy ONCA which may be challenging as boards and staff change.

On the other hand, lengthy and detailed comprehensive by-laws are generally more familiar to not-for-profit corporations. Directors, officers, members and employees can refer to such by-laws for most corporate governance questions without the need to reference the ONCA. However, by-laws cannot include every issue covered by the ONCA and a corporation might not realize that the by-laws may not contain all relevant information. Further, if language from the ONCA is included in the by-laws, the directors and members may not realize that they cannot change the wording.

Questions for Directors

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| <ul style="list-style-type: none">• Should a corporation use comprehensive or minimalist by-laws? |
| <ul style="list-style-type: none">• If transitioning to minimalist by-laws, what should be included and what can be excluded? |

VII. Conclusion

The ONCA provides for a comprehensive corporate governance regime for Ontario not-for-profit corporations which will be more inline with the corporate statutes governing business corporations. Although directors of not-for-profit corporations may be more familiar with the foundational principles of the ONCA, there will be particular nuances that directors will need to consider prior to making decisions regarding the governance structures of the corporations on whose boards they sit. It would be prudent for boards to engage expert advice in a timely manner to ensure that these legislative changes do not result in unintended or unwelcome consequences to their organization.