

**SUBMISSION ON:
MODERNIZATION OF THE LEGAL FRAMEWORK GOVERNING
ONTARIO NOT-FOR-PROFIT CORPORATIONS**

**ONTARIO AGENCIES SUPPORTING INDIVIDUALS WITH SPECIAL NEEDS
(OASIS)**

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**301 Wyecroft Road, Oakville Ontario L6K 2H2
email/courier electronique: oasis@oasisonline.ca
Website/site web: <http://www.oasisonline.ca>**

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PREFACE

This submission is the Ontario Agencies Supporting Individuals with Special Needs' (OASIS) response to the consultation paper prepared by the Ministry of Government Services entitled "Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations".

OASIS is an association with 136 member agencies sharing similar ideals and objectives. OASIS' goal is "To facilitate the sharing of ideas, resources, systems and information. OASIS will liaise with Government on behalf of member organizations with the goal of improving the development of cost effective quality supports for individuals with developmental disabilities."

This submission deals with select specific issues arising out of OASIS's review of the Ministry of Government Services' consultation paper. It is not intended to be a comprehensive review of all issues arising out of the proposed revision of the Ontario *Corporations Act*. It was prepared by OASIS with assistance from the Ottawa office of Gowling Lafleur Henderson LLP, and has been reviewed by the board of directors for OASIS and approved as a public statement of OASIS.

EXECUTIVE SUMMARY

The submissions of OASIS may be summarized as follows:

1. The structure of the Ontario *Corporations Act* should be modeled after the *California Corporations Code*.
2. The Ontario *Corporations Act* should move from a letters patent system of incorporation to a system of incorporation “as of right”.
3. The current provisions in the Ontario *Corporations Act* governing financial disclosure should not be changed.
4. The scope of director’s liability under the Ontario *Corporations Act* should be limited.
5. The Ontario Government needs to investigate with the Federal Government ways and means of alleviating or removing the current difficulties with directors and officers liability insurance.
6. Corporate powers and capacity under the Ontario *Corporations Act* should be similar to what is in effect under the *Ontario Business Corporations Act*.
7. The existing common law limitations on remuneration for directors of charities should be codified in the Ontario *Corporations Act*.
8. The Ontario *Corporations Act* should provide for multiple classes of not-for-profit corporations.
9. The current regulations and practices regarding the distribution of assets should be codified in the Ontario *Corporations Act*.
10. Commercial activity for not-for-profit corporations should be expressly permitted and regulated under the Ontario *Corporations Act*.
11. The current common law interpretation of “gains for its members” in the Ontario *Corporations Act* should be codified.

SUBMISSIONS

1. The Structure of the Ontario *Corporations Act* Should be Modeled After the *California Corporations Code*.

The structure of the current *Corporations Act* is long and somewhat difficult to navigate. A more user-friendly structure, similar to that of the *California Corporations Code*, should be adopted in Ontario. As is the case for the California Act, the Ontario Act could be divided into two parts -- the first part containing provisions of general application to all corporations falling under its ambit, and the second part containing a number of specific sections applying to designated types of not-for-profit corporations. This structure would make the Act more straightforward and accessible in that it would allow the reader to easily identify all the provisions respecting specific types of corporations, without having to review the entire statute.

The structure of the *California Corporations Code* is preferable to the current structure of many of the Canadian not-for-profit statutes, which require the reader to review the entire statute and the limitations and exceptions applying to each provision.

2. The Ontario *Corporations Act* should move from a letters patent system of incorporation to a system of incorporation “as of right”.

The letters patent process of incorporation is a dated and cumbersome process whereby the government has total discretion whether or not to allow a particular body to incorporate.

The Ontario *Corporations Act* should move from a letters patent system, to a system which provides for incorporation “as of right”. Under the current *Corporations Act*, not-for-profit corporations can only be incorporated through the filing of an application for letters patent, along with supporting documentation and the prescribed fee. In this manner, not-for-profit corporations are incorporated at the discretion of the Ministry of Government Services. Ministry staff conduct reviews of the applications and have authority under the statute to require revisions to the objects or purposes of the corporation if they appear to fall outside of the scope of the statute.

The exercise of discretion has allowed for the development of administrative practices that permit government officials to impose some restrictions on the incorporation of not-for-profit corporations. Where charitable objects are involved, the Ministry of Government Services has imposed an administrative policy whereby consent of the Office of the Public Guardian and Trustee must be obtained. The Public Guardian and Trustee will refuse consent for any application for incorporation based on certain factors, for example objects that are not exclusively charitable, or objects that are too broad or vague. The Public Guardian and Trustee also requires that certain provisions be placed in the powers clause of the incorporating document.

This application process, is slow and cumbersome as a result of the substantial involvement of the Ministry of Government Services and the Public Guardian and Trustee. The amendment process under the letters patent system is also troublesome, particularly because amendments cannot come into force until the government issues supplementary letters patent after a period of review by the Ministry of Government Services and where applicable, by the Public Guardian and Trustee.

A system providing for incorporation “as of right” would be much more practical. Incorporation “as of right” would allow not-for-profit organizations to be incorporated at the time of filing the documents and submitting the fees prescribed by law. If certain basic legal requirements are satisfied, the Ministry of Government Services would not be in a position to decline to issue a certificate of incorporation, but would only be able to insist on receiving those documents and fees prescribed by law.

Many other jurisdictions now permit not-for-profit corporations to incorporate “as of right” subject to certain statutory conditions that are imposed administratively,

such as restrictions on corporate names. In fact, all Canadian business corporations statutes now provide for incorporation “as of right”. Bill C-21: Canada Not-for-Profit *Corporations Act* also proposed to allow incorporation as of right. It is logical that Ontario should follow suit and allow incorporation “as of right” in the interests of uniformity and simplicity.

An improved *Corporations Act* allowing incorporation and amendments thereto “as of right” should also strive to eliminate a good deal of the red tape and some of the bureaucracy that can cause delays in having a not-for-profit organization incorporated. In such a regime, the role of the Public Guardian and Trustee could be reduced to more of an investigate function in the event of complaints. The onus would instead be on the not-for-profit corporations themselves, and specifically the directors, to ensure compliance with the *Corporations Act* and any guidelines passed under it.

3. The Current Provisions in the Ontario *Corporations Act* Governing Financial Disclosure Should Not be Changed.

There is no need to change any of the current provisions in the *Corporations Act* governing financial disclosure. The current provisions require not-for-profit corporations to keep proper books of account and accounting records with respect to all financial and other transactions (section 302). Accounting and other records must be kept at the head office of the corporation and open for inspection by any director during normal business hours of the corporation (section 304). Directors must present before each annual meeting of the members a copy of the corporation's financial statements, and an auditor's report in which the auditor provides an opinion about whether or not the financial statements present fairly the financial position of the company and the results of its operations in accordance with generally accepted accounting principles, if not exempt from an audit (section 97). This ensures accountability and is a good check and balance system.

The current *Corporations Act* does not require any particular form of public financial disclosure by not-for-profit corporations, nor does it provide access to the books of account to members of the organization. While it is important that members have access to a copy of the corporation's financial statements before each annual meeting of the members and an auditor's report, members should not be permitted to demand financial disclosure at random points throughout the year. Meeting such demands could cause excessive strain and hardship on the limited resources of not-for-profit corporations.

4. The Scope of Director's Liability Under the Ontario *Corporations Act* Should be Limited.

This is the most critical area for change. The current version of the *Corporations Act* does not explicitly set out the duty of care, standard of care and defences against liability applicable to directors and officers

Under the current regime, directors may be personally liable to account for losses arising as a result of a breach of their fiduciary duties, conflict of interest, fraud, negligence, or criminal behaviour. In the same manner, they can be liable for unpaid wages, taxes, and pension contributions owing by a not-for-profit corporation if that not-for-profit corporation becomes insolvent.

The not-for-profit sector has long been concerned with difficulties in recruiting and retaining qualified directors with such sweeping potential liability due to the wide range of activities in which not-for-profit corporations are engaged. To assist in alleviating these difficulties, the subjective standard that the common law presently imposes on directors should be abandoned in favour of an objective standard, which would be equally applicable to all directors regardless of their background. This would ensure that not-for-profit corporations are able to recruit competent and highly qualified directors who would not be unfairly burdened by a higher standard.

Another factor that OASIS would like to recommend is for the Ministry of Government Services to consider a financial limitation on the liability of directors and officers for civil actions. The amount of such limitation could be linked to the size of not-for-profit corporation. For instance, the limitation and liability for the directors of a not-for-profit corporation with substantial annual revenues should be higher than the limitation of liability for directors of a not-for-profit corporation with significantly less annual revenue. The various amounts could be prescribed from time to time pursuant to a regulation issued pursuant to the new *Corporations Act*.

OASIS agrees that an appropriate liability regime for directors and officers must take into account the need for directors and officers to be treated fairly and the need for accountability to those who suffer losses from breaches of duties by these individuals and / or their not-for-profit corporations.

5. Errors and Omissions – Liability Insurance for Directors and Officers

Finally a number of corporations are currently experiencing increasing difficulties in obtaining directors and officers' liability insurance coverage. Furthermore, at the present time, a majority of insurance companies do not appear to make a distinction between business corporations on the one hand and not-for-profit corporations and organizations on the other with the result that premiums for this type of insurance are much higher than they perhaps should be (i.e. the Voluntary Sector Initiative discovered that there was no disaggregated data on this topic). OASIS would recommend that the Ministry of Government Services investigate the possibility of a government sponsored or a government assisted insurance program with the appropriate representatives of the Federal Government. In particular, OASIS would strongly recommend that the Ministry of Government Services refer to the working papers and research (federal and provincial) prepared under the Voluntary Sector Initiative.

6. Corporate Powers and Capacity under the Ontario *Corporations Act* Should be Similar to what is in Effect Under the *Ontario Business Corporations Act*.

OASIS recommends that the corporate powers and capacity provisions in the current *Corporations Act* should be redrafted to be similar to what is in effect under the *Ontario Business Corporations Act*.

Corporations falling under the *Ontario Business Corporations Act* have the capacity and the rights, powers and privileges of a natural person, but may not carry on any business or exercise any power that is restricted by its articles. In sections 15 and 17, the *Ontario Business Corporations Act* explicitly states that no act of the corporation is invalid by reason only that the act is contrary to its articles, by-laws, a unanimous shareholder agreement or the *Ontario Business Corporations Act* itself. Under subsection 17(1), it is not necessary for a by-law to be passed in order to confer any particular power on the corporation or its directors.

Like the current *Corporations Act* provision, an *Ontario Business Corporations Act* corporation has the capacity to carry on its business, conduct its affairs and exercise its powers in any jurisdiction outside Ontario to the extent that the laws of such jurisdiction permit, as set out in section 16 of the Act. In effect, under the *Ontario Business Corporations Act*, acts that are in excess of the powers and capacities of the corporation under its articles and constituting statute will not be sanctioned with a nullity, even if all parties to the transaction knew that the transaction was in violation of the statute. However, such contracts would still be illegal and subject to the sanctions generally available at common law for illegal contracts. The Saskatchewan *Non-profit Corporations Act* and Bill C-21: Canada Not-for-profit *Corporations Act* both contain provisions regarding corporate powers and capacity that are similar to the *Ontario Business Corporations Act* provisions.

7. The Existing Common Law Limitations on Remuneration for Directors of Charities Should be Codified in the Ontario *Corporations Act*.

While profits and other funds of the not-for-profit corporation must be used in promoting the objects of the not-for-profit corporation, section 126 of the current Ontario *Corporations Act* provides that directors and officers are permitted to receive reasonable remuneration and expenses for their services as directors and officers and for services rendered in any other capacity, unless prohibited by the letters patent or corporate by-laws. However, this is subject to the common law rule that directors of charities are prohibited from receiving remuneration for their services in any capacity, without the approval of the court. For greater certainty, this common law rule should be codified in the Ontario *Corporations Act*.

8. The Ontario *Corporations Act* Should Provide for Multiple Classes of Not-for-Profit Corporations.

Currently the *Corporations Act* only provides for one class of not-for-profit corporation, which can have “objects that are within the jurisdiction of the Province of Ontario.” OASIS supports the creation of multiple classes of not-for-profit organizations under a revised *Corporations Act*.

A classification system is necessary due to the diversity of not-for-profit corporations in terms of membership, purposes, and sources of funding. A classification system with multiple classes could potentially meet the needs of each of the various types of not-for-profit corporations more adequately. Of course, the bulk of the provisions in the Act would continue to apply equally to all not-for-profit corporations. In this respect, the structure of the Act would be modeled on the structure in the *California Corporations Code*, as described above.

9. The Current Regulations and Practices Regarding the Distribution of Assets Should be Codified in the Ontario *Corporations Act*.

OASIS supports the idea of codifying in the Ontario *Corporations Act* the current regulations and practices regarding the distribution of assets.

10. Commercial Activity for Not-for-Profit Corporations Should be Expressly Permitted and Regulated Under the Ontario *Corporations Act*.

For-profit activities are becoming of greater importance to not-for-profit corporations in the face of reduced government funding. Often, grants and donations are received by not-for-profit corporations with the stipulation that the entire sum of the funds be used for a particular project or purpose, as opposed to funding overhead expenses. In order to survive, not-for-profit corporations must be expressly permitted to engage in commercial activities and have clear borders in terms of the degree to which they are permitted to do so.

Currently, the *Corporations Act* is not entirely clear on whether not-for-profit corporations can carry on commercial activity. The Act has widely been interpreted as allowing not-for-profit corporations to engage in commercial activities so long as these activities are incidental to the principal objects of the not-for-profit corporation and in furtherance of them. Commercial activities are also subject to the “non-distribution constraint” and the “not-for-profit purpose” requirement on not-for-profit corporations set out in the Act.

OASIS agrees with the suggestion that the revision of the *Corporations Act* should provide specific authorization to not-for-profit corporations to engage in commercial, for-profit activities provided that the principal activity of the not-for-profit corporation remains something other than commercial activity. This would not represent a huge shift in the industry; rather, it would merely provide formal recognition of the current reality. In order to ensure that not-for-profit corporations do not carry on an inordinate amount of commercial activity and take advantage of tax benefits associated with their status, it would be prudent to place a constraint on the amount of commercial activity not-for-profit corporations could engage in. OASIS suggests imposing a 25% ceiling. In this respect, the for-profit activities of a not-for-profit corporation could not constitute more than 25% of the corporation’s total annual revenues. If the not-for-profit corporation chose to partake in further for-profit activity, it would be free to set up a subsidiary for these purposes.

11. The Current Common Law Interpretation of “Gains for its Members” in the Ontario *Corporations Act* Should be Codified.

Section 126 of the current Ontario *Corporations Act* provides that a not-for-profit corporation “shall be carried on without the purpose of gain for its members.” Any profits or other funds of the corporation must be used in promoting its objectives. This provision is unclear as to what is intended by the prohibition on “gains for its members.” OASIS is concerned that this broad terminology creates the potential for families to be seen as receiving a gain if they are a member and receive respite or other types of benefits for their children. While the provision is likely intended to have the effect of a general non-distribution constraint, it is surely not intended to capture these types of benefits.

The prohibition should be clarified to prohibit the distribution of profits to members through dividends or any other form of direct distribution, and to preclude profit making activities except as incidental to the principal not-for-profit purposes unless there is an over-riding public benefit. Given that this has traditionally been the manner in which this provision has been interpreted, it makes sense to provide clarification of this intent in the statute itself.

CONCLUSION

OASIS appreciates this opportunity to provide feedback on the Ministry of Government Services' consultation paper, "Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations." OASIS is hopeful that the Ministry of Government Services will revise the Ontario *Corporations Act* in a manner that remedy the shortcomings of the current Act highlighted above. This will ensure that the new *Corporations Act* reflects the current reality for the not-for-profit sector in Ontario.