

Business Law

July 2011

Not-For-Profit Corporations: Watch for new federal and Ontario governance rules soon in force

Both the federal and the Ontario governments have introduced new legislation which will change the way not-for-profit corporations (“NFPs”) are constituted and governed. Neither piece of legislation is currently in force, but NFPs should be aware now of some of the key measures proposed in this legislation and the ways that the new legislation will affect NFP governance, operations and financial reporting.

The New Federal Regime

The *Canada Not-for-profit Corporations Act* (the “new Federal Act”) received Royal Assent in 2009 and is expected to be proclaimed into force before the end of 2011. The new Federal Act will replace the *Canada Corporations Act* (the “old Federal Act”), under which incorporation of NFPs was by letters patent and required government approval. In contrast, under the new Federal Act, NFPs will be able to incorporate as of right under articles of incorporation rather than letters patent. This change is expected to reduce the time, expense and paperwork needed to incorporate a new NFP. Further, under the new Federal Act, NFPs will no longer be required to have corporate “objects”. (Note however that NFPs that intend to seek registered charitable status under the *Income Tax Act* (Canada) (the “Tax Act”) should continue to include corporate objects and ensure that they are exclusively charitable as determined under the common law).

The new Federal Act is intended to modernize the regulatory framework for NFPs by aligning it more closely with the regime applicable to business corporations and by adopting current corporate governance rules. The new Federal Act also aims to clarify roles and responsibilities of NFP directors, members, officers and other stakeholders, and to increase the accountability and transparency of NFPs generally.

Significant provisions of the new Federal Act include the following:

- Members will have enhanced rights under the new Federal Act, including the ability to require directors to call meetings, submit meeting proposals and apply for leave of the court to bring a derivative action on behalf of the NFP.
- The new Federal Act also includes an oppression remedy which gives a member, director, officer or creditor of the NFP the right to apply to the court for an order that the court deems just upon the occurrence of any act that the court finds oppressive, unfairly prejudicial, or that unfairly disregards the interests of such member, director, officer or creditor.
- Federal NFPs will be required to file member-approved by-laws which set out membership conditions and voting rights. It should be noted that unanticipated complications may arise under the New Federal Act where the NFP has multiple classes of membership. Accordingly, legal advice should be sought before by-laws providing for multiple membership class rights are enacted.
- As with federally-incorporated business corporations, directors of federal NFPs will be required to disclose in writing any material interests that they may have in contracts or transactions with the NFP.
- Directors may also be held liable for certain liabilities of the NFP (such as unpaid wages, unremitted tax withholdings and certain distributions to members, officers and directors), subject to a due diligence defence.
- Directors will also be required to verify the “lawfulness” of the NFP’s articles and purpose. The reason for imposing this additional and unusual responsibility on directors is not entirely clear.
- While the new Federal Act does not have a requirement that a majority of NFP directors be residents of Canada, the residency of directors will be relevant to the NFP’s residency status for tax purposes.

The new Federal Act requires directors to act honestly and in good faith with a view to the best interests of the corporation. Specifically, directors must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The new Federal Act gives directors a due diligence defence which will allow them to rely in good faith on certain financial information and reports provided by officers and employees of the NFP as well as reports provided by certain professionals. In addition, the new Federal Act allows NFPs to indemnify present or former directors or officers as well as other individuals acting at the NFP's request as a director or an officer or in a similar capacity of another entity.

The new Federal Act introduces a new distinction between types of corporations. NFPs incorporated or continued under the new Federal Act will be classified as either "soliciting corporations" or "non-soliciting corporations". A soliciting corporation is one which receives (under the currently proposed Regulations) more than \$10,000 in donations, grants or governmental assistance over a three year period. A non-soliciting corporation is any NFP corporation which is not a soliciting corporation. Given these low thresholds, most active NFPs will be considered to be soliciting corporations.

The distinction between a soliciting and a non-soliciting corporation is relevant to several measures under the new Federal Act. For example:

- Soliciting corporations will be required to have at least three directors and at least two of these directors must not be employees, officers or directors of the NFP. Non-soliciting corporations are permitted to have a single director;
- Soliciting corporations with annual revenues exceeding certain thresholds must appoint a public accountant to review or audit their financial statements: under currently proposed regulations, those with annual revenues of more than \$250,000 must be audited annually, as must non-soliciting corporations with annual revenues of more than \$1,000,000;
- Soliciting corporations must file annual financial statements with Industry Canada, which will make

them available for public viewing. Generally, non-soliciting corporations will not be required to file financial statements but must make financial information available to members; and

- Soliciting corporations may only distribute their assets to qualified donees (e.g., registered charities and certain public bodies, as defined under the Tax Act) on dissolution.

All NFPs incorporated or continued under the new Federal Act will also be required to maintain books and records, including articles, bylaws, financial accounts, meeting minutes and resolutions, and registers for all members, directors and officers. NFPs will be required to make these documents available to members, creditors and Industry Canada officials on request. Debt obligations will also be subject to new rules similar to those applicable to federally-incorporated business corporations.

Once the new Federal Act is proclaimed into force, all federal NFPs incorporated under the old Federal Act will have approximately three years to continue under the new Federal Act. After three years, such corporations will be notified that they must either apply for articles of continuance or dissolve within a prescribed period. A federal NFP that is not continued (either under the new Federal Act or under another jurisdiction's legislation) will be automatically dissolved. Continuance under the new Federal Act is also as of right and is automatic on the filing of articles of continuance. However, the NFP must certify that its members have adopted by-laws which conform to the new Federal Act.

The New Ontario Regime

The *Ontario Not-for-Profit Corporations Act, 2010* (the "new Ontario Act") received Royal Assent in October 2010 and is expected to be proclaimed into force in early 2012. The new Ontario Act will replace the *Corporations Act* (Ontario) (the "old Ontario Act") and will provide Ontario NFPs with a regulatory framework similar to that applicable to business corporations incorporated under the Ontario *Business Corporations Act*. Like the new Federal Act, the new Ontario Act is intended to enhance corporate governance and accountability for NFPs, simplify the

incorporation process, enhance members' rights and better protect directors and officers from personal liability.

Some of the main features of the new Ontario Act include the following:

- Incorporation under the new Ontario Act will be as of right by articles of incorporation as opposed to the old letters patent. An NFP will be required to state its purposes in its articles of incorporation and must specify that any commercial purpose is intended only to advance or support its non-profit purposes.
- Directors of NFPs that are incorporated or continued under the new Ontario Act will have a statutory duty of care: specifically, the requirement to act honestly and in good faith with a view to the best interests of the corporation. Such duty of care will be subject to a reasonable due diligence defence which will allow directors to rely in good faith on certain financial information and reports provided by officers and employees of the NFP as well as reports provided by certain professionals. Directors will also be required to comply with the NFP's articles and by-laws.
- The new Ontario Act will provide better protection from personal liability for directors and allows NFPs to provide indemnification to directors or officers, former directors or officers and individuals acting at the NFP's request as a director or officer, or in a similar capacity, of another entity.
- Enhanced powers and rights will be granted to members, including the ability to make meeting proposals. Under certain circumstances, such as on a proposed disposition of all of the NFP's property or other fundamental change, non-voting members will be granted voting privileges.
- More stringent notice requirements will be imposed for meetings, but such notices may be delivered and meetings may be conducted electronically.
- Different requirements will apply with respect to audit and review engagements by public accountants depending on the NFP's status under the new Ontario Act and on its annual revenues. For example, a "public

benefit corporation" (analogous to a soliciting corporation under the new Federal Act) will be required to have an audit if its revenues exceed \$500,000 annually. (Charitable corporations are considered to be public benefit corporations under the new Ontario Act.)

- Like the new Federal Act, the new Ontario Act allows derivative actions to be brought on the NFP's behalf. However, it is notable that the new Ontario Act does not provide for an oppression remedy as the new Federal Act does.

The Ontario Ministry of Consumer Services (the "Ministry"), which has responsibility for the new Ontario Act, intends to prepare standard-form by-laws which will be deemed to apply to a NFP 60 days after it is incorporated unless customized by-laws are filed within that time.

In order to continue under the new Ontario Act, existing Ontario NFPs will be required to ensure that their letters patent and by-laws conform to the new Ontario Act by filing Articles of Amendment and amending by-laws. The new Ontario Act provides that any provision of a NFP's original constating documents which is not amended to conform to the new Ontario Act within three years of the new Act coming into force will be deemed to be amended to the extent necessary for conformity. An exception applies to NFPs with objects that are "of a social nature" (i.e., social clubs) – the old Ontario Act will continue to apply to such NFPs for five years, following which they will be automatically dissolved unless they have been continued under the new Ontario Act or the laws of another jurisdiction.

Things for NFPs to Consider Before the New Acts are in Force

Both federal and Ontario NFPs will need to consider now, before the new legislation takes effect, a number of governance and record-keeping issues. These issues include:

- How the new acts will impact their current organizational structure and the possible advantages of continuing under the legislation of a different jurisdiction.

- Which, if any, of its by-laws should be amended before the new legislation comes into force, e.g., to remove membership classes.
 - The articles of incorporation or continuance and the by-laws which should be put into place within specified time periods after the relevant coming-into-force periods.
 - The need for on-going maintenance and filing of corporate records and the requirements for audit or review engagements with respect to financial statements under the relevant legislation.
- If you require any assistance in preparing for the new legislation, please contact a member of our Business Law Practice.

Michelle Hooshley and Liana Turrin are members of the Business Law Practice at Pallett Valo LLP.



Pallett Valo LLP Business Law Practice

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We are pleased to announce that Greg Azeff has recently joined Pallett Valo in the Business Law Practice and the Insolvency & Corporate Restructuring Practice. Greg's experience includes acting for companies of all sizes across a wide range of industries, serving on multiple boards of directors, and serving five years as CEO of a Canadian technology company. Welcome, Greg!

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