

# Ontario Not-For-Profits: Some Significant Features in the New Legislation

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## Introduction

Ontario has revised its legislative scheme for not-for-profit corporations (“NFPs”). The New Act is called the *Not-For-Profit Corporations Act, 2010* (“Act”) and is expected to come into force before the end of 2012. It is meant to “modernize” Ontario’s not-for-profit sector and align it closer to the governance model already in place in the for-profit sector.

It is important to know that **these changes apply to all existing Ontario NFPs**, not just new NFPs that are incorporated after the new Act comes into force.

**All existing Ontario NFPs should review their existing constitutional documents and take steps to bring themselves into conformity with the new Act.** The sooner they start this process the better.

The purpose of this article is to outline some important features of the scheme that will be implemented by the new Act **once it comes into force**. It is a starting point only. The issues set out below are not in any particular order of priority and are an incomplete and rough summary for information purposes only. The final Act and its regulations will have to be reviewed in detail whenever a particular question or issue arises.

In addition, there may be some duplication in the bullet points set out below. Because this article makes use of broad headings some bullets needed to be set out in more than one place.

## Continuation and Transition Issues for Existing Ontario NFPs: Change Your By-Laws or Have Them Changed For You

The Act will apply to all Ontario NFPs as soon as it comes into force, other than co-operative corporations.

All Ontario NFPs will have to review their Letters Patent and by-laws and consider what amendments they need to make in order to comply with the new legislation. Ontario NFPs that do nothing will be deemed to have amended their Letters Patent and by-laws to comply with the Act on the third anniversary of its coming into force, and any provisions in their Letters Patent and by-laws that are not in compliance with the new Act will be deemed to be amended to be in compliance.

## Charity Law Prevails

The Act confirms that when there is a conflict between this Act and any other legislation dealing with charitable corporations, then the other charitable corporation law prevails.

Also, this Act only relates to corporate governance issues. Ontario NFPs that are now or want to become charities for income tax purposes have to comply with Canada Revenue Agency (“CRA”) requirements related to obtaining and maintaining charitable status, and the CRA charitable status guidelines are not changed by these statutory reforms.

## “Public Benefit Corporations”

The Act has different rules for public benefit corporations than it does for other NFPs. “Public benefit corporations” (“PBCs”) are NFPs that receive more than \$10,000 per year in the form of gifts or donations from non-members or from government assistance. This exempts NFPs that receive virtually all their income from member donations or membership dues.

PBCs have additional requirements to satisfy including the following:

- No more than one-third of all directors of a PBC can be employees of the PBC.
- Depending on their level of income PBCs will by extraordinary resolution be able to (i) dispense with an auditor and have review engagement financial statements only (more than \$100,000 and less than \$500,000 in revenue) or (ii) have neither audited nor review engagement financial statements (\$100,000 or less in revenue) (all figures subject to change by regulations to the Act).
- A PBC will not be able distribute the fair value of a membership to a member upon termination of that member’s membership.
- On winding up of a PBC, its remaining property may only be distributed to a charity with similar charitable purposes (if it was a charity) or to some other PBC with similar purposes or to a government agency (if a non-charity).
- Members of a PBC will not have dissenting rights under the Act.

## Incorporation, Articles and Capacity and Powers

- One person will be able to incorporate an Ontario NFP; the requirement for a minimum of three incorporators will be gone.
- Another body corporate will be able to incorporate an NFP; so a for-profit company for example will be able to have a wholly owned or partially owned not-for-profit subsidiary.

- The purposes of the NFP will still have to be set out in its Articles.
- Each member will have one vote, unless the Articles provide otherwise.
- NFP actions will not be invalid simply because they are contrary to the NFPs Articles, by-laws or the Act.
- Articles may also set out any matter which can be set out in the by-laws, allowing and NFP to have a single constitutional document.
- NFPs will be incorporated as a matter of right, and the existing pre-approval process will be done away with.
- An NFP corporation will have all the capacity, rights, powers and privileges of a natural person.
- The indoor management rule will apply to NFPs, and directors, officers and agents of the NFP can bind the NFP to third party obligations even if they exceed their authority in doing so.
- It will be possible to have pre-incorporation contracts adopted by the NFP after it is incorporated.
- All members have one vote per member, unless the Articles provide otherwise (i.e. it is now possible to have members with more than one vote). However this must be addressed in the Articles and cannot be left to the by-laws.
- Memberships will not be transferable unless the Articles or by-laws provide otherwise.
- The directors borrowing power will be included in the statute, but may be modified in the Articles or by-laws.
- The directors will be able to require membership dues, subject to the Articles and by-laws.
- The directors will have broad investment powers, subject to the Articles and by-laws.

## **By-laws**

- The Articles will be able to include all the matters that are normally covered by an NFP's by-laws, which means by-laws can be dispensed with completely and the NFP may need only one organizational document.
- If the directors of a new NFP do not pass organizational by-laws within 60 days of incorporation, they will be deemed to have passed standard organizational by-laws as approved and published by the Ministry from time to time. In other words, there will be

Ministry approved standard by-laws for NFPs to use, and those will come into play automatically within 60 days of incorporation unless the directors take the active step to approve some other form of by-laws. While not 100% clear it would appear that this section of the Act will not apply to NFPs that have included the by-laws in their Articles.

- The by-laws will have to set out the conditions for membership, matters related to transferring or withdrawing from each class, and the disciplinary process and consequences for members in default. These issues will no longer be left to directors’ discretion.
- Directors will have the power to make, amend or repeal by-laws, as long as they are subsequently ratified by the members.
- Directors will not have to be members of the NFP, unless the by-laws require it.
- Subject to by-laws, directors will be entitled to receive reasonable remuneration.
- Members will have the right to propose by-laws or the amendment or repeal of existing by-laws at any annual members meeting.
- The by-laws may permit persons to become members by virtue of their office.
- Memberships will not be transferable unless the Articles or by-laws provide otherwise.
- Unless the by-laws require otherwise a majority of voting members at the opening of the meeting will be required for there to be a quorum.
- By-laws may provide for voting by mail, telephone or electronic means, instead of proxy voting.
- The directors borrowing power will be included in the statute, but may be modified in the Articles or by-laws.
- The directors will be able to require membership dues, subject to the Articles and by-laws.
- The directors will have broad investment powers, subject to the Articles and by-laws.

## **Directors**

- A person who occupies the position of director will be deemed to be a “director” within the meaning of the Act irrespective of their title.
- It will not be necessary for the by-laws to confer any particular powers on the directors.

- An NFP will have to have at least three directors, but the remaining directors will be able to continue to exercise their powers even if this quorum is not satisfied.
- Directors will not have to be members of the NFP, unless the by-laws require it.
- By-laws may provide for persons to be directors by virtue of their office, and those directors cannot be removed from the board by the members for so long as they hold that office.
- Directors may not hold office without standing for re-election for more than four years.
- Directors may hold office on different or staggered terms.
- Different classes of members can have election or removal rights for specific directors.
- Any director or member can apply to court to review any controversy with respect to the election or appointment of a director of the NFP.
- Directors will have the power to make, amend or repeal by-laws, as long as they are subsequently ratified by the members.
- Directors will be entitled to attend and be heard at all member meetings.
- Unless the Articles or by-laws require otherwise, a majority of directors will be required to form a quorum.
- Telephone or electronic participation in board meetings will be permitted.
- Directors will be personally liable to the NFP for payments or distributions to a member, officer or director, or the provision of any indemnity, contrary to the Act, if they voted in favour or consented.
- Directors will be jointly and severally liable to the employees of the NFP for up to six months wages and twelve months vacation pay.
- Directors will have statutory conflict of interest requirements they have to meet.
- Directors will be subject to a statutory duty to act honestly, in good faith and in the best interests of the NFP.
- Directors will have a statutory duty to exercise the care, diligence and skill of a reasonably prudent person under similar circumstances.

- Directors will have a statutory diligence defence available to them including reasonable reliance on financial statements and reports and advice from officers, employees and professional advisors.
- Subject to by-laws, directors will be entitled to receive reasonable remuneration.

## **Officers**

- A person who performs the functions of an officer will be deemed to be an “officer” within the meaning of the Act whether they have been formally appointed or not.
- Officers will have statutory conflict of interest requirements they have to meet.
- Officers will also be allowed to be directors.
- Any one person will be able to hold two or more offices.
- All NFPs will be required to appoint a chair, who shall be one of the directors.
- Officers will be subject to a statutory duty to act honestly, in good faith and in the best interests of the NFP.
- Officers will have a statutory duty to exercise the care, diligence and skill of a reasonably prudent person under similar circumstances.
- Officers will not have a statutory diligence defence, which will be available to directors only.
- Subject to by-laws, officers will be entitled to receive reasonable remuneration.

## **Members**

- Members will have a statutory right of limited liability.
- An NFP will have a lien on a membership interest for any debt owing by the member to the NFP.
- Members will have the right to propose by-laws or the amendment or repeal of existing by-laws at any annual members meeting.
- Members will be able call meetings to fill vacancies necessary to complete board quorum.
- Any member will be able apply to court to review any controversy with respect to the election or appointment of a director of the NFP.

- Conditions for membership have to be set out in the corporation’s by-laws, and will no longer be something that can be left to director discretion.
- The by-laws may permit persons to become members by virtue of their office.
- If there is more than one class of members the by-laws have to set out the conditions of membership and matters related to transferring or withdrawing from each class.
- An NFP may have more than one class of members, and only one class of members has to have voting rights (i.e. the practise of having non-voting members will continue to exist).
- All members have one vote per member, unless the Articles provide otherwise (i.e. it is now possible to have members with more than one vote). However this must be addressed in the Articles and cannot be left to the by-laws.
- Corporate or organizational members will be entitled to have a personal representative and the NFP has to recognize that individual’s ability to exercise those membership rights at meetings.
- Memberships will not be transferable unless the Articles or by-laws provide otherwise.
- Discipline powers and the circumstances under which they may be exercised will have to be included in the by-laws.
- There will be a statutory obligation of good faith in exercising discipline powers, including a minimum written notice period and an opportunity for the member to be heard.
- An aggrieved member will have a right to apply to court if they believe they have been unfairly disciplined or terminated.
- Member meetings may include conference call or electronic participation.
- Voting members will have the right to put matters on the agenda for members’ meetings.
- Members representing at least 5% of the voting members in a class will be able to propose directors for nomination.
- If the NFP refuses to put a member proposal to the membership the member in question will be able to apply to court to force the matter.
- Unless the by-laws require otherwise a majority of voting members at the opening of the meeting will be required for there to be a quorum.
- Voting will normally be by way of a show of hands, but any member can require a ballot.

- Voting by proxy will be permitted, and the NFP will have to provide a proxy form with every notice of meeting.
- By-laws may provide for voting by mail, telephone or electronic means, instead of proxy voting.
- Members representing at least 10% of the votes, or a lesser amount if permitted by the by-laws, will be able to require the directors to call a members’ meeting.
- Members will be able to apply to court to have the court call a meeting.
- Members will be able to apply to the court to appoint an auditor and fix remuneration, or to review any matter related to the appointment of an auditor.
- Members will be able to insist that the auditor attend a members’ meeting and answer questions.
- Members of NFPs that are not PBCs may in some circumstances receive (i) the value of their membership from the NFP on termination of their membership or when exercising dissenting rights, or (ii) a share of the remaining property in the NFP following the NFPs winding up.
- Members will not be able to waive their rights unless expressly permitted by the Act.

## **Financial Reporting and Accountability**

- As a general rule NFPs will have an auditor appointed by the members.
- However PBCs can, depending on their level of income, decide by extraordinary resolution to dispense with an auditor and have review engagement financial statements (more than \$100,000 and less than \$500,000 in revenue) or neither an audited nor a review engagement financial statement (\$100,000 or less in revenue) (all figures subject to change by regulations to the Act).
- And other corporations can, depending on their level of income, decide by extraordinary resolution to (i) dispense with an auditor and have review engagement financial statements (more than \$500,000 in revenue) or (ii) have neither audited nor review engagement financial statements (\$500,000 or less in revenue) (all figures subject to change by regulations to the Act).
- An auditor will have to be appropriately qualified and independent, and the criteria for independence will be spelled out in the Act in some detail.
- Members and directors will be able to apply to the court to appoint an auditor and fix remuneration, or to review any matter related to the appointment of an auditor.



- An auditor will be entitled to attend all member meetings.
- A director or member will be able to insist that the auditor attend a members' meeting and answer questions.
- When an NFP changes auditors it will have to circulate a statement to the members explaining why the change is being made, and the auditor being changed may also make a statement that has to be circulated to the members.
- A new auditor will not be permitted to accept an appointment unless it has requested a statement from the previous auditor as to the circumstances and reasons for the change in auditors.
- Present and former directors, officers, employees and agents of the NFP will have to co-operate with the person conducting an audit or review engagement including the provision of information and explanations.
- NFPs will be able to have audit committees but a majority of its members must not be employees or officers of the NFP.
- Errors subsequently discovered in financial statements must be reported to the directors, who will have a duty to re-issue the statements.
- Financial statements will have to be approved by the directors and presented to the members including any accountant or auditor reports.

## **Corporate Finance**

- The directors' borrowing power will be included in the Act, but may be modified in the Articles or by-laws.
- The directors will be able to require membership dues, subject to the Articles and by-laws.
- The directors will have broad investment powers, subject to the Articles and by-laws.
- Profits will not be distributable to members, directors or officers except in furtherance of the NFPs objects.
- However if the NFP is not a PBC it may distribute the fair value of membership to a member upon termination of that member's membership, and it is possible that the remaining property of the NFP may end up being distributed to the members following its winding up.

## Records

- NFPs will have to maintain certain corporate records including Articles, by-laws, minutes, resolutions, director consents, registers, financial statements and accounting records.
- Directors will have access to those records.
- Members, their lawyers and NFP creditors will also have access to some of the records and information.

## Fundamental Changes, Liquidation and Dissolution

- A special resolution of members will be required to implement a mandated list of changes including changes to the NFP name, objects, membership classes, conditions of membership, membership rights, the distribution of property on liquidation, notice provisions re: member meetings or anything required to be set out in the Articles.
- Any director or member will be able to propose changes to any of the items on the list.
- Non-voting members will have statutory voting rights with respect to changes that affect their membership rights and status.
- NFPs will be permitted to amalgamate by following the amalgamation process required by the Act.
- Non-voting members will have voting rights when it comes to amalgamations.
- NFPs incorporated in other jurisdictions will be able to apply for continuance in Ontario.
- Ontario corporations not covered by the new Act will under certain circumstances be able to apply for continuance under the new Act.
- Ontario NFPs will be able to apply for continuance into another jurisdiction.
- A sale, lease or exchange of all or substantially all of the property of the NFP will require member approval.
- Non-voting members will have voting rights when it comes to such transactions.
- Voting members will be able to wind up or dissolve an NFP by special resolution.
- Members and non-members will also be able to seek a winding up of an NFP by court order on various grounds including when the affairs of the NFP are being managed in a way that unfairly disregards or is prejudicial to the interests of a member, creditor, director or officer.

- On winding up of a PBC, its remaining property will only be distributable to a charity with similar charitable purposes (if it was a charity) or to some other PBC with similar purposes or to a government agency (if a non-charity).
- On winding up of a non-PBC, its remaining property will only be distributable in accordance with its Articles, or to its members if there is no statement in its Articles.
- Members of NFPs that are not PBCs will have dissenting rights when it comes to some fundamental changes, which can include a requirement that the NFP pay them the fair value of their membership.

## Other Remedies

- A member or creditor will be able apply to the court for an investigation into the affairs of the NFP.
- Members, directors and officers and former members, directors and officers will be able apply to the court for leave to bring, continue or defend an action on behalf of the NFP when the NFP is not otherwise proceeding to do so (i.e. derivative action rights).
- Those persons, and creditors, will be able to apply to the court for compliance or restraining orders with respect to NFPs that are not complying with the Act, the regulations, its Articles or its by-laws.
- Criminal liability could be imposed on persons who do not comply with the Act including a fine up to \$5,000 and imprisonment up to 6 months, including directors or officers who authorized, permitted or acquiesced in the commission of an offense by the NFP.

## Concluding Thoughts

Not everything from the for-profit sector approach made it into the new Act. It does not include any provision permitting the NFP equivalent to a shareholder agreement or pooling agreement, which leaves very limited room to modify or avoid its provisions. On the other hand there is no direct NFP equivalent to the very broad oppression remedy found in the Ontario *Business Corporations Act*, although there is a judicial investigation power that goes a long way down that road.

All-in-all the new Act will introduce a complete, comprehensive and self-contained code of authority, rights and responsibilities on all Ontario NFPs. It will not only modernize the system and bring NFP governance into close alignment with the for-profit sector, but it will also significantly expand director accountability and member rights. It is very important that Ontario NFPs immediately begin planning for these changes, so they can anticipate and adjust for the new way of doing things in an orderly and thoughtful manner.