

Reform of the Canada Corporations Act:  
The Federal Not-for-Profit Framework Law

Thematic Summary of the Consultations  
May 9 to June 19, 2002

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## Background

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For five weeks in the spring of 2002, a team from Industry Canada crossed the country listening to the views of stakeholders on proposals for a new Not-for-Profit Corporations Act. Over three hundred individuals participated in the consultation sessions, while others sent in briefs to the consultation Web site.

A preliminary round of consultations was held in the previous fiscal year, and feedback from those first consultations and commissioned research studies was incorporated into the two discussion papers circulated prior to this second round of consultations. Written in plain language, *Reform of the Canada Corporations Act: Draft Framework for a New Not-for-Profit Corporations Act* promotes a corporate governance structure grounded on the themes of transparency, accountability, fairness, and efficiency. The second volume, *Discussion Issues for a New Not-for-Profit Corporations Act* highlights some of the proposals in more detail.

## Findings

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In general, participants praised Industry Canada for its consultation process. A number of stakeholders who had participated in the preliminary round of consultations thanked Industry Canada for incorporating many suggestions in the new framework proposal.

Participants were generally supportive of the various reform proposals. Strong support was expressed for the proposals concerning: the due diligence defence; the standard of care; indemnification and insurance; and limiting liabilities of directors and officers. There was a divergence of views amongst participants on issues such as: a classification system; the filing of by-laws; and audit requirements.

Participants had several overarching concerns at each of the consultations:

### **Co-ordination with other federal statutes and provincial legislation is imperative.**

- Many participants were concerned with ensuring that new legislation would fit with other federal statutes and provincial legislation. In each venue, participants concluded that co-ordination and consistency at the federal and provincial levels is imperative.

### **There is ongoing confusion about the distinction between not-for-profit corporations and registered charities.**

- Many issues that arose were tax specific and, as such, under the jurisdiction of the Canadian Customs and Revenue Agency (CCRA) and the Ministry of Finance.

**Discussion of many issues returned to the need for a classification system.**

- Although participants were divided on the need for a classification system, discussion of many other issues returned to the question of whether to include a classification system in a new act.

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## **Structure of the Act**

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### ***Classification System***

Reaction about the merits of including a classification system in the new not-for-profit legislation was mixed across the country. However, participants returned to this issue time and again, often noting that other issues could not be resolved without deciding on the issue of a classification system.

Those opposed to the inclusion of a classification system felt it would unduly complicate matters. One of the reasons offered was that it would be difficult to classify some organizations because of the varied work that they do and/or the services that they provide. Another concern was that organizations might inappropriately self select, given that their *raison d'être* could differ from their motives for providing services.

A number of participants were in favour of a classification system that was either based on levels of revenue or number of members or that distinguished between public benefit, mutual benefit, religious and, in some cases, political organizations.

### ***Filing By-laws***

There was general agreement that moving away from the archaic letters patent system was a positive step. With respect to the filing of by-laws, a number of participants expressed support for the simpler structure proposed; in fact, a minority of participants agreed that there should be no filing requirements at all.

There was a difference of opinion on whether by-laws and amendments should take effect immediately upon passage by members, or only when filing was complete.

Some did not see the benefit of filing at all if by-laws become effective when passed. Others noted that there could be problems if by-laws did not become effective at the moment when members passed them, particularly for organizations that do not meet frequently. One person predicted that with a filing requirement but no scrutiny, Industry Canada would end up with “the worst of both worlds”: organizations that are not in compliance with the law and filed by-laws that are inaccurate. Participants in a number of cities voiced concern about the possibility of an increased security risk without thorough scrutiny.

### **Repository function:**

Recognizing that some organizations have rapid turnover and limited corporate memory, many participants supported the notion of the government acting as a central repository. There were several requests for Industry Canada to put by-laws online if it accepts the repository role.

### **Model by-laws:**

Most participants agreed that model by-laws would be very helpful, and urged they be kept simple. Some asked for the creation of an easily updateable Web interface, including secure access and summary reports.

## **Disclosure and Accountability**

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### ***Access to financial statements***

A majority of participants across the country were in favour of the framework proposal that organizations be required to make corporate financial statements available to members, directors, officers, and the Director. However, not all agreed that members should be subject to a fee for copies of the financial statement, and many more disagreed with the proviso to allow exemptions to the requirement.

Those opposed to the requirement were concerned that a requirement to make financial statements available could be burdensome and expensive.

A number of participants at one meeting objected strongly to the Director having access to financial statements at any time. One suggested that the law be written in as narrow a context as possible, only granting the Director a right to information for a specific purpose.

It was proposed that a clearer definition of “financial statement” be developed. A number of participants participant took exception to the notion that financial statements are presented to members “for their approval” (page 45, *Draft Framework for a New Not-for-Profit Corporations Act*). A suggestion was made to change the language on page 45 to read, “...directors would be required to present the audited reports,” without mentioning approval or acceptance.

### **Exemptions:**

Several participants in Edmonton, Regina, and Toronto were very concerned about the proposal to allow exemptions from the disclosure requirements, arguing that issuing an exemption would place Industry Canada between the auditor of an organization and the organization itself. Exemptions were seen to contravene the principles of transparency and accountability, and should only be granted according to clearly articulated criteria.

### ***Membership lists***

A majority of participants agreed with the framework proposal that would allow members to obtain copies of the membership list of their organization, provided that the framework is narrowly defined and access is restricted. Several asked that the issue of selling lists be addressed. Some participants noted that it would be essential to ensure that the new act mesh with other federal legislation including the *Personal Information Protection and Electronic Documents Act* and the *Anti-Terrorism Act*.

In order to circumvent the release of membership lists that include names, addresses, and telephone numbers, it was suggested that an organization charge for undertaking mailings on behalf of members in order to ensure that the privacy of members is not breached.

The definition of “member” was confusing to some and worrisome to others. Some organizations define members as anyone who receives services while others include donors. The statement on page 35 of the *Draft Framework for a New Not-for-Profit Corporations Act* (“The Act would contain a provision defining a member as ‘anyone designated by the board of directors’”) alarmed some participants and elicited a promise to clarify the wording.

Some participants believed that signing an affidavit in order to obtain a membership list would be pointless. The cost—the expense of tracking down individuals to sign the affidavit in the first place and pursuing legal action in the event of an infraction—was also seen as problematic.

In addition, the proposed timelines were questioned. The allotted 15 days for changes was seen as too short, and the requirement to maintain records for six years was viewed as “impossible” for many organizations.

### ***Audit Requirements***

Rather than the framework proposal that stipulates a prescribed amount as a threshold above which corporations would be required to have annual audits, most participants across the country favoured a graduated approach, or one based on classification, materiality, or size.

Many supported the Saskatchewan model in which provincially incorporated not-for-profits with revenues of over \$100,000 must be audited, those between \$25,000 and \$100,000 must have at least an internal review, and those with less than \$25,000 have no audit requirements. Concurrent with this was widespread support for the adoption of a graduated standard such as a review engagement, which is less than an audit but satisfies an understanding of the costs involved.

Other suggestions included differentiating between organizations that receive public funding and those that do not, or basing it on classification. For example, if an organization is classified as political it should be required to have an audit regardless of its size; a charitable organization with tax benefits should be subject to a threshold; and mutual benefit organizations could determine their own thresholds.

Suggestions were made to adopt the *Canadian Generally Accepted Accounting Principles* rather than keeping separate books for protection against not-for-profit corporations using their tax benefits to subsidise for-profit activities, or to have separate statutes for charitable and non-charitable organizations.

### **Auditors:**

Representatives of the Canadian Institute of Chartered Accountants (CICA) did not agree with the framework proposal as it pertains to auditor qualifications and proposed that the new act adopt the *Canadian Business Corporations Act (CBCA)* definition of “auditor”. The opposite view was conveyed by representatives of the Certified General Accountants (CGAs) of Ontario. There were several calls to have audits not be restricted to either CGAs or CAs if made mandatory. Some agreed that a smaller organization should be able to agree to an internal review by a non-accountant, provided that individual had no ties to the board.

Two specific suggestions were made about the wording in the *Draft Framework for a New Not-for-Profit Corporations Act*:

- The last paragraph on page 46 be amended to read, “The auditor meets the standards of the auditing profession.”
- Page 47, “Right to attend meetings,” implies that the auditor’s expenses to attend all meetings would automatically be paid by the corporation, something that might be a burden for small organizations. It was suggested the wording could be changed to “the auditor is entitled to attend at the request of the board, and expenses will be paid.”

## **Directors’ Liability**

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### ***Standard of care***

The vast majority of participants at the ten consultations favoured the adoption of the framework proposal that specifies that every director or officer of a corporation would owe a duty of care to the corporation. This objective test would create a uniform standard of care for directors and officers, and is clearly understood by Canadian courts.

It was noted that there could be ambiguity in the notion of “acting in best interest.” As many organizations registered as not-for-profit corporations address a public good, one participant wondered about a potential conflict of interest when a director acts in the best interest of the entity as opposed to the community it was designed to serve.

Participants emphasized the need for consistency with other statutes such as the *Canadian Human Rights Act*, the *Employment Standards Act*, and the *Income Tax Act*, commenting that little can be changed in one without amendments to the others.

### ***Due Diligence Defence***

There was unanimous approval of the framework proposal that would include a due diligence defence for directors and officers of not-for-profit corporations. Participants saw this as a codification of common law and “the right thing to do.”

### ***Indemnification and Insurance***

A majority of participants favoured adoption of the framework proposal that would broaden the scope of situations under which would: allow organizations to indemnify directors and officers; provide mandatory indemnification of directors and officers in specific circumstances; and allow corporations to purchase insurance. Many participants were concerned about insurance issues, and many supported advancement of defence costs.

Many participants across the country were very concerned that the cost of insurance would be prohibitive for small organizations or impossible to obtain.

### ***Limiting Liabilities of Directors and Officers***

A majority of participants agreed with the framework proposal that places no statutory limit on liabilities for directors and officers, and encourages proper care and diligence in the management of organizations.

Participants who supported the framework proposal liked the idea of clarifying but not limiting liability.

## **Remedies**

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### ***Derivative Action***

The draft framework proposal does not make a recommendation with respect to the derivative remedy. The concept of including a derivative remedy received mixed reviews across the country. Those opposed to providing for derivative action said its inclusion could be used to burden organizations with frivolous actions, or allow a third party to hijack the agenda of an organization.

Those who favoured the inclusion of the derivative remedy felt its inclusion was necessary in order to ensure accountability and credibility. A number of others saw this “mechanism of accountability” as important, and urged that it be included as a hallmark of modern statutes. Others suggested keeping derivative action as a remedy, but limiting access so that small special interest groups could not abuse it, and clarifying the rules under which it could be used.



### ***Oppression Remedy***

Participants were mixed in their reaction to the framework proposal, which does not provide for an oppression remedy.

Those who agreed with its exclusion included a participant who argued that any one disgruntled member could use it to halt the workings of an organization. It was pointed out that common law remedies remain for truly distressful situations.

Among those who argued in favour of including the oppression remedy was one participant who contended that there are many disputes within not-for-profit organizations, and therefore, a real need for remedies.

In Quebec, a participant found this option redundant because such protection was already available under civil law.

### ***Dissent Right and Appraisal***

A strong consensus emerged across the country for the proposition that the dissent right and appraisal remedy should not be included in a new act, but that corporations should be free to include similar provisions in their articles or by-laws.

### ***Natural Justice and Fair Procedures***

The framework proposal includes no provisions respecting natural justice and fair procedures. A majority of participants from across the country agreed with the framework proposal. Many participants liked the fact that corporations would be free to include these provisions in their articles and by-laws rather than enshrining them in the Act.

### ***Modified Proportionate Liability***

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Most participants in St. John's, Halifax, Winnipeg, Edmonton, and Vancouver agreed with the framework proposal not to include a modified proportionate liability (MPL) regime, while several participants in Montreal, Ottawa, Toronto, and Regina did not agree with it. A number of the comments made during the consultations were actually points of clarification that reflected the highly technical nature of this subject area.

One participant saw no valid reason for including MPL in the statutes as not-for-profits are not the type of corporate organizations that need it. Another disagreed, and urged that MPL be included, stressing the importance of consistency in legal approaches. Secured creditors rely on audited statements, and auditors would be liable to secured creditors, as would directors and officers. A suggestion was made to make the NFP statute consistent with the *CBCA*.

The CICA argued that MPL should be included in the Act for the sake of fairness—accountants should be responsible for their own acts, but not the acts or omissions of others. A person who makes a relatively small or non-existent contribution to a wrongful act should not, in all fairness, have unlimited liability.

## **Corporations Sole**

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The framework proposal, which has no provision allowing for the creation of corporations sole, met with strong approval across the country. However, the provision to allow standard not-for-profit corporations to be set up with only one director and one member (which could be the same person) was not enthusiastically embraced. Many participants in most cities preferred to see a minimum of three directors.

## **Other Issues**

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### **Transition period/Continuance:**

Participants in most cities had questions about the transition period and process, as well as what the next steps would be.

Some suggested an opt-out provision, arguing that without one there would be such active opposition to the new law from some groups that the Act would be scuttled, as previous proposed legislation had been.

There was general support for the framework proposal of automatic continuance under the new act after a three year period. It was observed that the alternative to the transition model set out in the framework proposal is mandatory dissolution of non-compliant organizations. This had occurred in Ontario with the transition to the *Ontario Business Corporations Act*, when nearly half the corporations were dissolved, resulting in pandemonium.

### **Disclosure/ Conflict of interest:**

Participants at several venues expressed concern about disclosure requirements. A number agreed there should be a mechanism to disclose fees and salaries paid to officers and directors. Some felt they should apply to all organizations, not just ones that raise funds from the public. It was pointed out that this issue could be dealt with through by-laws that specify that only full-time directors or officers receive compensation.

There was disagreement about the merits of remunerating directors and officers, but general support for leaving the decision up to the membership.

### **Organizational structure/Incorporation:**

The rationale of allowing an applicant for incorporation to be a corporation was questioned. In particular, there was concern that the incorporating body would stay on the board indefinitely, effectively making the organization a director. It was clarified by Industry Canada officials that the reform proposals would not allow corporate directors.

Another fear was that, under the framework, only directors could appoint officers, whereas at present, members can. It was pointed out that members choose officers in most lay organizations.

Referring to page 38 in *Draft Framework for a New Not-for-Profit Corporations Act*, a participant said that members could submit proposals for consideration, and the corporation could refuse to include that proposal in a notice of meeting. The procedure says that if the member does not agree with the decision, the meeting could be delayed by court order, something that could cause long, problematic delays.

Also on page 38 (*Draft Framework for a New Not-for-Profit Corporations Act*) under “Members’ Proposals,” a participant suggested it would be preferable to allow organizations to prescribe the period of membership in their by-laws rather than having them detailed in the Regulations. There was also concern that members could abuse the idea of member proposals.

Under “Amendment of articles and by-laws” on page 49 (*Draft Framework for a New Not-for-Profit Corporations Act*), a participant suggested that rather than prescribing that two-thirds of the members present would have to agree, organizations should be allowed to decide the actual number in their by-laws.

### **Location and notice of meetings:**

Several participants commented that the “meetings of members” section was impractical as it pertained to designating a specific place in Canada. Under the proposed Act, it is stipulated that a corporation’s by-laws should designate a place in Canada, chosen by the directors, where the meetings of the members of a corporation would be held. It was noted that many organizations might want to move meetings around the country, something that participants argued should be allowed as long as they take place in Canada.

A suggestion was made that the increase to 21 days of notice for members meeting would seem to be a step in the wrong direction and the high quorum requirement was also questioned.

In response to the proposal requiring the time limit between annual general meetings to be fifteen months, participants noted the difficulty in having financial statements ready for members at the AGM.

A participant recommended that members be given the power to call a special meeting directly, in the event that directors refuse to call one after having been directed to do so by the members. Others agreed that this would be useful protection for dealing with “rogue boards.”

### **Proxy voting:**

The proposed legislation states that organizations can choose whether or not to have proxy voting. A participant found this worrisome, as people who actually attend the annual general meetings learn more details of the issue in question. At that point, the proxy votes are already made and cannot be altered.

Provisions on page 43 (fines or jail time for proxyholders who ignore directions) were called “heavy-handed.” Several participants recommended their removal from the Act.

### **Stakeholder Interest Clauses:**

Several participants at the Toronto meeting supported the notion of including stakeholders’ interest clauses in relevant legislation. One contended that the principles of the accord between the government of Canada and the voluntary sector implicitly support stakeholder recognition and rights. The difficulty in defining stakeholders can be overcome in organizational mission statements.

However, another participant cautioned that this could create ambiguity regarding directors’ liability and create a situation where there is a paucity of case law. Yet another agreed, arguing that the not-for-profit category is so broad that most organizations do not have stakeholders in the conventional sense, and that directors would be paralysed by potential liabilities.

### **Unanimous Member Agreements:**

Many participants questioned the use of Unanimous Members’ Agreements (UMAs), with one strongly advising that trust powers not be delegated by way of a UMA.

Participants were concerned about the “slippery slope” of member agreements, one noting that all the powers of a director cannot be taken away without vesting them elsewhere. A suggestion was made that if members do assume the liabilities, they should also have the same right to indemnification.

### **Opt-out for religious organizations:**

A few participants stressed the importance of providing an opt-out for religious organizations.

**Other suggestions and comments:**

- Turning not-for-profit corporations into true direct democracies where members are consulted on every decision can impede the efficiency of decision-making.
- Framers are asked to pay attention to encouraging risk management techniques in not-for-profit organizations.
- Not-for-profit organizations have advantages in the marketplace over for-profit corporations by virtue of their access to funding dollars and tax benefits creating competition problems.