

## **ONN Briefing Note - April 17<sup>th</sup> 2013**

*The ONN commits to updating this briefing note as new information is available.*

### **Requesting Clarity And Amendments To The Ontario Not-For-Profit Corporations Act To Enable And Support The Work Of Organizations Providing Public Benefit In Ontario**

The ONCA, the new corporate legislation for the Not-for-Profit (NFP) sector was designed to provide uniformity with the Ontario Business Corporations Act and, while many of the provisions in the new act are suitable for the sector, there are instances where the sector has evolved important sector-specific practices that are not accommodated.

The intent and purpose of a non-profit organization with its commitment to mission is very different from that of a business corporation so it should not be a surprise that the sector needs some provisions in its corporate legislation that support and enhance its role in building strong communities.

The amendments required are few and are straightforward to make. Should these amendments be made, the ONCA will become the legislation of choice for NFP organizations. Should these amendments not be made, stability concerns and administrative limitations will force many unwanted restructurings on sector organizations. Regrettably, these restructurings will make the sector less inclusive and less resilient. Some organizations for whom restructuring is not an option may face destabilizing tensions as member's interests conflict with public benefit missions and obligations.

In this brief, we outline why amending the legislation is so important, what are the most immediate steps required, and recommend key amendments that will assist the NFP sector in its work and greatly simplify the transition process to the new legislation.

#### **The Immediate Challenge**

***There is increasing agreement and concern among charity law lawyers and their NFP clients that the transition provisions in the ONCA are inadequate to allow NFP organizations to reorganize and restructure under the existing Corporations Act during the three year transition period post proclamation of the ONCA.***

Consultants estimate it takes 18 months for volunteer Boards and their working groups to undertake significant revisions to organizational structure and operations. Even if organizations struck transition working groups immediately they are missing key information to make decisions including the default by-law and regulations.

## **Recommendation:**

- **Clarify the transition provisions in the legislation, before the ONCA is proclaimed, to ensure NFP organizations have, as promised, a complete three year transition period, to restructure under the existing Corporations Act.**

## **Critical and Facilitative Amendments**

Amendments to ONCA are required to ensure stability and responsiveness in the sector and prevent long-term damage to the structure of the sector.

As expected with new legislation, as organizations and members of the legal community have begun to work with the ONCA, areas of difficulty and confusion have emerged. There are some provisions in the act that do not support the traditions and practices that have served the sector well over the years. The sector's role in communities needs to be supported, not undermined, by their corporate legislation.

As the sector transitions to the ONCA, approximately 70% of organizations have memberships larger than their Board of Directors.<sup>1</sup> This number is expected to decrease significantly. Charity law lawyers have identified to their NFP sector clients that the most effective way to protect NFP organizations and their assets from the uncertainties brought by the ONCA are to restrict membership to members of the Board of Directors. While effective in the short term, in the long term, this insular solution makes organizations vulnerable to governance problems with no way for the organization to self-correct and renew. The restricted membership approach stabilizes the organizations but at the expense of inclusiveness and community involvement. Regrettably, many organizations feel they have no other responsible option in the face of so much potential volatility.

There are a number of organizations (estimate 30%) with deeply embedded membership traditions that will not be able to adopt the restricted membership solution.<sup>2</sup> A significant number of these organizations anticipate serious challenges from a small number of disaffected or radical members who now have the tools to disrupt the organizations significantly and repeatedly.

Eighty-five percent of NFP organizations have a public benefit mission (60% charities, 25% NFP). The ONCA needs to support this fact by recognizing the multiple accountabilities these public benefit organizations have to many stakeholders (funders and the public), not just to their members. Boards of Directors have traditionally managed these multiple accountabilities between members, funders and the public mission. The ONCA however, has strengthened member rights (as if they were shareholders) thereby constraining the ability of Boards to navigate between the sometimes conflicting interests.

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<sup>1</sup> ONN surveyed the 800 participants of its workshops and webinars regarding the ONCA regarding the characteristics of their organizations memberships.

<sup>2</sup> Ibid.

For example: In organizations providing services to people with developmental disabilities, the members of the organization are typically the family members of people in service. However the mission of the organization is to serve all people in the community with developmental disabilities. In addition, the government funds the organization to deliver specific services. Often the interests of these three stakeholders will align but sometimes their interests will differ. Under the ONCA, it is not clear that Boards of Directors will be able to juggle the various interests of the stakeholders for the public interest. The ONCA has treated members as if they are the only ones with an interest in the corporation.

The ONCA also needs to provide Ontario communities with assurance that those public benefit organizations that are not charities, have a long-term commitment to building community wealth in their communities. Under the ONCA, such organizations can move in and out of being public benefit corporations and can take their assets with them. This is not in the public's interest. And finally, a few provisions in the act will cause significant difficulty in the sector in the way they are constructed. Minor adjustments to these provisions can have a huge impact on the ease with which NFP organizations will be able to comply. These streamlining amendments have broad support throughout the sector.

Charities have permanent locks on their assets - meaning if they dissolve their assets are passed on to other charities so the assets always remain in the public domain. With not-for-profit corporations who are not charities, they can divide their assets among their members when they dissolve. This works for corporations that serve their members (clubs) but not for corporations that provide public benefit in communities. Under the ONCA, these public serving organizations would only have a three year lock on their assets after which the assets could be divided among members should they dissolve. This is open to abuse. The arena build with community funds and serving a community purpose should remain a community asset. All organizations providing public benefit, whether charities or not-for-profit organizations should have the same permanent lock on their assets that keeps them in the public domain

The amendments required are set out in three sections:

1. **Rebalance members' roles and rights** to accommodate broader stakeholder participation.
2. **Strengthen the commitment to community** for Public Benefit Corporations.
3. **Save time and simplify operations.**

## **1. Rebalance Members roles and rights to allow for broad stakeholder participation.**

In many public benefit organizations, the interests of the membership, the interests of the public and the interests of the funders are not always aligned. Boards of Directors must be able to balance the interests of their funders, the interests of their membership and the interests of their communities. Giving one group the power to override the interests of the others (as in the ONCA) is very problematic and will cause innumerable and serious conflicts in the sector and in communities. Members have traditionally played a “guardianship” role in NFP corporations – ensuring strong individuals are elected to the board of directors to implement the public good mission of the organization. The five changes proposed will reposition members as the “guardians” of the corporation not the “sole beneficiaries”.

**1.1 Member resolutions should not be binding on Boards of Directors.** In business corporate legislation, including the OBCA, member resolutions are advisory and non-binding on Boards of Directors. The ONCA as currently written appears to allow binding resolutions from members<sup>3</sup> which will place many Boards in difficult positions as member resolutions may be at odds with an organization’s contracts and agreements with funders and community obligations. We anticipate significant numbers of organizations will find themselves unable to recruit qualified candidates to serve on their voluntary boards of directors given the uncertainty in the new legislation. Should the courts find member proposals binding we will have a serious crisis in board member recruitment and retention across the province.

- **Clarify that member proposals are advisory only and NOT binding on Directors.**

**1.2 Members should not be able to propose by-law amendments which if passed are binding on the organization.** By-law revision is complicated and we believe that both members and Boards of Directors should have to approve by-law changes. Neither party should have sole discretion to change by-laws.

- **Ensure By-laws amendments require board AND member approval.**

**1.3 Eliminate voting classes of members.** Groups of members may have different interests or roles e.g. honorary members, youth members, but they are not minority shareholders who have different financial interests in the corporation. NFP organizations should be allowed to organize their members into groups but such members should all be part of ONE class of members for voting purposes.

- **Eliminate Voting classes.**

**1.4 Make non-voting members non-voting.** The ONCA currently gives non-voting

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<sup>3</sup> Lawyers disagree over whether the legislation, as drafted, makes member proposals binding. All agree however, that the issue will have to be determined in court.

members a vote on key corporate issues of fundamental importance. The sector's longstanding practice of having non-voting members not have a vote should be respected. Non-voting members (minority shareholders) in a business corporation have a financial interest in the corporation. Non-voting members in member based nonprofit organizations rarely have a financial interest and, in public benefit corporations, non-voting members never have a financial interest.

In member based corporations, to the extent that they have a right to participate in a distribution of the remaining assets on winding-up of the corporation, non-voting members of such a non-public benefit sector corporation should have the right to vote on matters which might affect their economic interest. However, there is no justification for giving voting rights to otherwise non-voting members who have no financial interest. Indeed, the sector created non-voting members precisely for individuals who should not have a vote. In the sports sector, all the participating children (over 3 million) are non-voting members, and in other sectors non-voting members are corporations, other community organizations or for example magazine subscribers that wish to support and affiliate with the organization.

- **Eliminate voting rights for Non-voting members who have no residual economic interest in the corporation.**

**1.5 Organizations should be permitted the choice whether to use proxies and electronic voting based on their needs.** Many sector organizations do not like mandatory proxies, as they want to encourage members to attend meetings at which important issues are discussed before a decision is made. Others have members with language and literacy challenges whose participation can best be facilitated in a meeting. Still other organizations that would be willing to use proxies strongly disagree (e.g. safety concerns) with the inability to specify that proxy holders be members. Organizations in the sector vary widely. They need flexibility and choice.

- **Make proxies and electronic voting optional.**

**1.6 Amending fair value payout for member-based organizations by specifying the amount of payout.** Organizations that are not public benefit and exist to serve their members in the ONCA are required to pay to dissenting members the "fair value" of their memberships – even if they have decided that there is not to be any distribution of net assets on dissolution to members. The fairest and easiest is to restrict the payout to the member to the amount of loans the member made to the corporation. This will avoid many conflicts and misunderstandings in the non-PBC corporations. Valuing the corporate membership will be difficult and costly. It also makes sense to provide for equal distribution of assets on dissolution unless the by-laws provide other wise.

- **Specify fair value payout for dissenting members**

## **2. Strengthen The Public Benefit Corporation**

The public, funders and indeed many working in the sector, believe that nonprofit organizations in their communities all meet the same core criteria that demonstrate their commitment to the public good. Those criteria are:

- The organization has a public purpose and mission;
- The organization operates for the public good not personal gain.
- The organization reinvests any excess revenue in its public purpose; and
- The organization retains its assets in the public domain for the public good

In its current form, the ONCA does not provide the assurance the public needs by ensuring that public benefit organizations meet these four basic criteria. Indeed, the ONCA actively prevents many nonprofit organizations providing public benefit (the 25% of the sector who provide public benefit but are not charities) from offering permanent non-distribution guarantees to their funders and communities. As a sector, we worry about this disconnect between what funders and the public expect and what is provided in the new act. We worry that ONCA will permit unscrupulous operators to abuse the public's trust to the detriment of all.

**2.1 Provide an “opt-in” option to a clear and permanent definition of Public Benefit Corporation** based on organizational purpose (not revenue source). This will ensure all organizations working for public benefit have a transparent, permanent and higher threshold of accountability to their communities.

- **Provide a Permanent opt-in option for NFP organizations to be Public Benefit Corporations.**

**2.2 Provide a permanent no-distribution constraint on dissolution for all nonprofit organizations opting to be Public Benefit Corporations.** This will ensure their assets remain in the public domain for the long-term and eliminate confusion and potential for misuse created by the current temporary three-year asset lock in the ONCA. Charities and the new social purpose business legislation - the American L3C and British CIC all have permanent non-distribution constraints. If Ontario's nonprofit legislation does not have similar restrictions it will be seriously out of step with modern practice. This change will require eliminating the \$10,000 trigger for qualifying as a Public benefit corporation for an opt-in option.

- **A Permanent non-distribution constraint for all Public Benefit Corporations.**

### **3. Streamline and Simplify Administration.**

The administrative burden on corporations imposed by this new act is unnecessarily onerous on both NFP organizations and their regulators. There are a few provisions in this act where very minor changes can have a significant impact.

**3.1 Set out the number of directors in By-laws not articles.** The ONCA requires the number of Directors be set out in the articles. This has the practical impact of requiring that every single NFP organization amend their articles. Moreover, as their needs change, they will be obliged to amend their articles every time they adjust the number of Directors. Depending on the age and stage of an NFP organization, they may want to adjust the number of their directors. (E.g. As a start-up they might have a very small board that grows as they get established or if an organization is about to embark on a significant project they might want to increase the number of board members.) Even with a sliding scale, boards will want to adjust their board size from time to time. This should be possible by amending their by-laws as they have done without problem for generations. NFP organizations do not need to incur the complications and expense of amending articles to adjust the number of directors.

- **Set out the Number of Directors in By-laws not articles.**

**3.2 Reduce the 21 days lead time for financial statements to 3 days so June annual meetings can continue to occur.** Twenty-one days may seem reasonable but the practical impact of this time period is to push the majority of annual meeting into September. This will significantly disrupt the rhythm of activities in NFP organizations. In Ontario, many organizations receiving funding from the government will have a March 31 year end to line up with the Ontario government year end. This means the NFP year end coincides with individual tax filings due April 30. Auditors, therefore, do not have time to audit NFP corporations until May. As currently stands, auditors and NFP boards have to rush to complete, receive and review the audit in time for annual meetings that are traditionally scheduled in June so Boards of Directors can hit the ground running in September. The 21 days requirement for access to financial statements before an annual meeting cannot be met in June and since Boards traditionally do not meet in the summer annual meetings will be delayed to September, six months after the year-end. From an accountability stand-point timely review by members of financial statements is more important than a long review time.

- **Reduce the 21 days lead time for access to financial statements to 3 days so June annual meetings can continue to occur.**

**3.3 Raise the audit threshold from \$100,000 to \$500,000 for Public Benefit Corporations.** Audits and review engagements are increasingly expensive. Typically they will cost \$10,000- \$20,000. On a budget between \$100,000 and \$499,000 this is a

significant amount of money that could be spent on programs. Public Benefit Corporations should have the same threshold for audits and review engagements as member based organizations. Should there be concerns, funders and members can always request an audit. The higher threshold provides a better balance between expense and accountability needs.

- **Raise audit threshold from \$100,000 to \$500,000 for Public benefit Corporations.**

**3.4 Eliminate the requirement that the Chief Executive Officer take over Board of Director responsibilities upon the resignation of the Board.** This provision appears to be taken from litigation among business corporations where the CEO is often the chief shareholder. In an NFP corporation, the staff are paid employees and it is not appropriate that they be expected to assume Director liabilities simply because they continue to operate the activities of the corporation. This appears to be a situation where the cross over from the business corporation to the nonprofit corporation does not apply.

- **Eliminate the requirement that the Chief Executive Officer take over Board of Director responsibilities upon the resignation of the Board.**

*This brief including the technical detail of the amendments that follow, is the result of feedback from Ontario Nonprofit Organizations and the detailed work and advice of the ONN Expert Working Group.*

*Thanks to Brian Iler, Cliff Goldfarb, Pat Bradley and Lynn Eakin.*



## Technical Details of Amendments – Ontario Not-for-Profit Corporations Act

The next section provides suggested wording and deletions for the ONCA to achieve the objectives outlined in this brief.

### Details of Amendments - Ontario Not-For-Profit Corporations Act

#### TRANSITIONAL PROVISIONS.

##### Amend section 207(2) to read

The provisions of the *Corporations Act*, and not this Act continue to apply to the corporation until the earlier of the date the corporation advises the Ministry in writing that it wishes to be governed by this Act, and the third anniversary of the day this section comes into force. On that date, this Act, and not the *Corporations Act*, applies to the corporation, and any provision in letters patent, supplementary letters patent, by-laws or any special resolution of a corporation that was valid immediately before the day this section comes into force and that has not been amended to bring it into conformity with this Act is deemed to be amended to the extent necessary to bring the provision into conformity with this Act.

Consequentially, section 4(1) should be amended to begin, “Subject to s. 207(2),”.

#### 1. MEMBER RELATED AMENDMENTS

##### Reverse the Power of Members to Override Directors

- Ensure Members proposals are not binding on Directors

##### Delete wording

21. ~~Subject to this Act~~, the directors of a corporation shall manage or supervise the management of the activities and affairs of the corporation. 2010, c. 15, s. 21.

##### Amend 56.1 and 60.1

56. (1) A member entitled to vote at an annual meeting of the members may,  
(a) give the corporation notice of any matter that the member proposes to raise at the meeting for any purpose connected with the affairs of the corporation that is not inconsistent with this act, referred to as a “proposal”; and  
(b) discuss at the meeting any matter with respect to which the member would have been entitled to submit a proposal. 2010, c. 15, s. 56 (1).

60.1 The members of a corporation who hold at least 10 per cent of votes that may be cast at a meeting of the members sought to be held, or a lower percentage that is set out in the by-laws, may requisition the directors to call the meeting for any purpose connected with the affairs of the corporation that is not inconsistent with this act stated in the requisition. 2010, c. 15, s. 60 (1).

*The ability of the members to override the directors comes from the insertion of the phrase “Subject to this Act,” in section 21 of the new Act. That section otherwise gives the directors the exclusive authority to “manage or supervise the management of the business and affairs of a corporation”.*

*In the Business Corporations Act, the phrase is “Subject to any unanimous shareholder agreement,” (s. 115).*

*As a result, the provision allowing for member proposals to be made to a members’ meeting is not overridden by s. 21. In a business corporation, only a shareholders’ agreement can override the general authority of the directors – which is as it should be.*

***The fix is to re-insert the wording from the current Act in both s. 56 and 60: “any purpose connected with the affairs of the corporation that is not inconsistent with this Act”.***

- **Members should not be able to propose by-law amendments which if passed are binding on the organization**

**Delete**

~~17 (6). A member entitled to vote at an annual meeting of the members may make a proposal to make, amend or repeal a by-law in accordance with section 56. 2010, c. 15, s. 17 (6).~~

*By-laws are not to be lightly amended or able to be amended solely by either the Board or the Members. The existing act has a better system of amending by-laws with better checks and balance.*

- **Eliminate class voting rights**

**Delete**

**S. 105 (1), (2), (3)**

~~103 (1) A special resolution of the members or, if section 105 applies, of each applicable class or group of members, is required to make any amendments to the articles of a corporation to,~~

103. (1) (c) delete  
103. (1)(d), delete  
103. (1) (e) delete  
103. (1) (f), delete  
103. (1) (g), delete  
103.(1) (k), delete  
103. (1) (l) delete

*NFP organizations do not have classes of members (minority shareholders) that need to be treated differently for voting purposes. They may have different member groups but this does not translate into different voting rights – all have equal interest in the corporation.*

- **Eliminate voting rights for Non-voting members,**

**Delete S.105 (2), 111(3), 116(3), 118(4)**

*Sector uses non-voting members as an affiliation strategy to engage constituencies that should not have a vote.*

**Make proxies optional and restrict proxy holders to members**

**Amend (S.64 (1) to read** If provided in by-laws every member entitled to vote at a meeting of the members may by means of a proxy appoint a proxy holder or one or more alternate proxy holders, who may be required to be members, as the member's nominee to attend and act at the meeting in the manner, to the extent and with the authority conferred by the proxy. 2010, c. 15, s. 64 (1).

*Voting with proxies or electronic voting should be decided by each organization.*

- **Amending Fair value payout for member-based organizations by specifying the amount of payout for dissenting members.**

**Amend S.187 (8)** In addition to any other right the member may have, but subject to subsection (26), a member who complies with this section is entitled, when the action approved by the resolution from which the member dissents becomes effective, to be paid by the corporation the amount, if any, of the members loans to the corporation, including any capital contribution, held by the member in respect of which the member dissents, determined as of the close of business on the day before the resolution was adopted. 2010, c. 15, s. 187 (8).

**To enshrine the default distribution,**

**Amend 150(1)(b)(ii)(B) and s167 (1)(d)(ii)(B) to read**

If there is no provision in its articles for distribution of property, equally among its members.

*These changes avoid difficulties and disputes around valuing the corporation every time a member leaves or on dissolution where no provision has been made.*

## 2. STRENGTHEN PROTECTION FOR COMMUNITIES IN PUBLIC BENEFIT CORPORATIONS

- **Provide and “opt-in” option to a clear and permanent definition of Public Benefit Corporation.**

### **AMEND DEFINITION OF Public Benefit Corporation (PBC) to permit all nonprofits to choose to be public benefit corporations.**

1. (1) “public benefit corporation” means,
  - (a.) a charitable corporation, and
  - (b.) a non-charitable corporation, the articles of which provide that the corporation is a public benefit corporation for the purposes of this Act

*The definition of public benefit corporation draws on the similar definition of non-profit housing co-operative, in the Co-operative Corporations Act and the transitional provision contained in Section 26 of the Co-operative Corporations Statute Law Amendment Act, 1992.*

- **Ensure for all Public Benefit Corporations a robust non-distribution constraint, including successor obligations.**

### **New section 89.1**

89(1) This section applies to public benefit corporations and to those other corporations articles of which provide that the corporation is subject to the provisions of this section (“asset locked corporation”).

(2) Any profits or accretions to the value of the property of an asset-locked corporation shall be used to further its activities

(3) An asset-locked corporation cannot be converted into or continued as any other kind of corporation and no attempt to do so is effective.

(4) An asset-locked corporation shall not distribute or pay any of its property to its members during its existence or on its dissolution.

(5) Despite subsection (4), an asset-locked corporation may pay a member,

(a) amounts owed to the member including interest on a member loan or any other loan from the member at a rate not exceeding the prescribed maximum annual percentage; or

(b) reasonable amounts for goods or services provided by the member.

(6) No person shall accept compensation for the withdrawal of membership by a member of an asset-locked corporation other than,

(a) compensation for amounts owed to the member by the co-operative; or

(b) compensation for improvements made by the member to the property of an asset locked corporation if the compensation is reasonable and is approved by the board of directors.

(7) A person who accepts compensation in contravention of this section shall pay the asset locked corporation an amount equal to the value of the compensation or the excess compensation and that amount is a debt the asset-locked corporation may recover in a civil proceeding.

(8) An asset-locked corporation may not amend its articles to do anything described in s. 102(1)(j) or (m) or amend its articles so that the corporation is no longer an asset-locked corporation and no attempt to do so is effective.

(9) An asset-locked corporation may not amalgamate except with another asset-locked corporation.

*Similar provisions in the Co-operative Corporations Act have been found effective to prevent a sale of assets to members: see Bridlewood Co-operative v. Superintendent of Financial Services of Ontario, a decision of the Superior Court of Justice, dated April 5, 2005.*

### 3. STREAMLINE AND SIMPLIFY ADMINISTRATION

- **Set out the number of Directors in the By-laws not articles**

**30. (1)** The members of a corporation may amend its ~~articles~~ (insert by-laws) to increase or decrease the number of Directors, or the minimum or maximum number of directors, but a decrease shall not shorten the term of and incumbent director, 2010,c. 15,s30.1

**103. (1) (h) Delete**

- **Reduce the 21 days lead time for access to Financial statements to 3 days so June annual meeting can occur.**

**84. (2)** Not less than ~~21~~ (insert 3) days before each annual meeting of the members or before the signing of a resolution under section 59 in lieu of a the annual meeting, a corporation shall ~~give~~ make available a copy of the documents referred to in subsection (1) to all members who have informed the corporation that they wish to receive a copy of those documents. 2010.c.15, s.84. (2)

- **Raise the Audit or review engagement threshold of Public Benefit Corporations from \$100,000 to \$500,000 – similar to non public benefit corporations**

**Delete S.76 (1)(a) (b)**

**Amend**

**76(2)** Members of a corporation ~~other than a public benefit corporation~~ may pass an extraordinary resolution

Members of a corporation may pass an extraordinary resolution,

(a) to have a review engagement instead of an audit in respect of the corporation's financial year if the corporation had annual revenue in that financial year of more than \$500,000 or such other prescribed amount; or

(b) to not appoint an auditor and to not have an audit or a review engagement in respect of the corporation's financial year if the corporation had annual revenue in that financial year of \$500,000 or less or such other prescribed amount. 2010, c. 15, s. 76 (2).

*There is no need for the lower threshold in Public Benefit corporations and the costs are prohibitive.*

- **Eliminate the Requirement that the Chief Executive Officer take over Board of Director responsibilities upon the resignation of the Board.**

**Delete**

~~29. (1) If all directors have resigned or have been removed without replacement, a person who manages or supervises the management of the activities or affairs of the corporation is deemed to be a director for the purposes of this Act. 2010, c.s.28 (6)~~

**or qualify that**

**This section 29, (1)** does not apply to an employee or volunteer who was not, within 3 months of commencing to act in such a capacity, a director of the corporation.

*A salaried or volunteer senior staff person cannot assume Board responsibilities with all the attendant liabilities and responsibilities. An NFP corporation is not the same as the business corporation where the shareholders continue to run corporations after Directors resign and ought to be held responsible.*