ONTARIO NONPROFIT NETWORK

Key amendments needed for the Ontario-Not-for-Profit Corporations Act before proclamation
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About Ontario Nonprofit Network
The Ontario Nonprofit Network (ONN) is the independent network for the 58,000 nonprofits in Ontario, focused on policy, advocacy and services to strengthen Ontario's nonprofit sector as a key pillar of our society and economy.

ONN works to create a public policy environment that allows nonprofits to thrive. We engage our network of diverse nonprofit organizations across Ontario to work together on issues affecting the sector and channel the voices of our network to governments, funders, and other stakeholders.

ONN, with the assistance of a working group of charity law lawyers, is proposing amendments to the *Not-for-Profit Corporations Act, 2010* (ONCA). ONN and its network are pleased that the Government of Ontario has agreed to entertain these important amendments as they proclaim the ONCA.

ONN's presents the following seven amendments that will make a significant difference to enable Ontario's nonprofit sector to operate within a statute that supports and enhances their work in communities. These amendments will alleviate confusion and difficulties in the implementation of the Ontario Not-for-Profit Corporations Act (ONCA).

ONCA Working Group Members
ONN: Cathy Taylor, Lynn Eakin
Charity Law Specialists including: Terrance Carter and Theresa Man, Carters Charity Law; and Susan Manwaring, Miller Thomson

Part I. Background to Recommended Changes

- **Why amendments are needed**

A bit of background on the ONCA is in order to understand why this legislation must be amended before it is proclaimed. The ONCA, when in force, will be the corporate legislation that governs nonprofits incorporated in Ontario, replacing the Ontario *Corporations Act*, which, despite being decades out of date, is still the governing legislation for our sector. Consultation began in 2007 on

what was to become the ONCA, with the bill being passed in 2010 but not proclaimed. There was an effort among legislative drafters at that time to harmonise all corporate legislation, so nonprofit legislation was patterned after legislation for business corporations. The *Canada Not-for-Profit Corporations Act* (CNCA) was drafted in this fashion, as well as the ONCA.

There have been some difficulties with using a business legislative model for the nonprofit sector. Key parts of the legislation, for example, giving shareholders rights and privileges that protect their financial investment, simply do not fit the needs of the nonprofit sector where members do not have financial interests in the corporation (nonprofits do not have shareholders). The CNCA was proclaimed in 2011 and the nonprofit sector and its legal advisors have had a number of years of experience with the legislation and the cumbersome workarounds necessary for the sector to make the statute work for them.

As we approach proclamation of the ONCA, we have identified seven key amendments regarding implementation that would greatly benefit the sector. Making these key changes will shift the ONCA from a "make do corporate framework" to one that meets and supports the membership and governance needs of the nonprofit sector.

Overview of the Changes Needed

- **Clarify use of restated articles of amendment for transition of existing corporations, including specifically how to transition to a floating number of directors.**

  Rationale: Transitioning to the ONCA for 58,000 organizations will be a huge change for organizations and the government. Clarity regarding when and how organizations have to file articles of amendment will be helpful for both organizations and Service Ontario.

- **Repeal provisions giving non-voting members voting rights in certain situations.**

  Rationale: The nonprofit sector uses non-voting membership to broaden involvement in the organization and deepen community engagement. Sport and recreation organizations, for example, have thousands of junior members who do not have voting rights (i.e. youth soccer players, hockey players, etc.). Other organizations have made funders and patrons non-voting members to acknowledge and include them in the organization. Organizational membership in the nonprofit sector is used to build a sense of collective inclusion. While the ONCA drafters intended to increase membership rights and participation by giving non-voting members voting rights in certain situations, the current legislation will accomplish the opposite. By mandating non-voting member voting rights, the impending shift to the ONCA as it stands has led many organizations to collapse or eliminate their stakeholder and community memberships. While the government made an announcement that non-voting rights would not be proclaimed for at least three years after the ONCA comes into force, the announcement does not provide sufficient certainty for organizations. The sector intends non-voting members to be non-voting and legislation should allow this.

- **No class votes as default; permit articles to include an "opt-in" for class votes.**

  Rationale: The nonprofit sector has no shareholders; instead, organizations have members. These members do not have a personal financial interest to protect. The mission drives the organization and members collectively direct the organization in accordance with the mission. Treating different groups of members as though they are classes of shareholders does not match the way the nonprofit sector operates. While many organizations have different groups of members, such as youth members or regional members, the purpose of these categories is to include diverse involvement in the organization to make decisions together- not to establish different groups with veto powers. Should an organization want class votes, they can opt in. In our experience, the vast majority of organizations will choose not to have class votes.

- **Permit delegate voting.**

  Rationale: Some organizations with wide or layered membership continue to use a system of delegate voting. This system permits the voting members to elect delegates to represent them at the meetings and is currently permissible under the Ontario *Corporations Act*. It should continue as a legitimate form of member engagement under the ONCA.

- **Eliminate confusion on binding effect of member proposals.**

  Rationale: Directors, especially those governing public benefit nonprofits, have a duty to current members and also to their communities, funders and future members. Unless a proposal pertains to members' rights and responsibilities, proposals from the membership should be advisory and not binding on the Board of Directors. We believe this is a drafting error because all other corporate legislation, both business and nonprofit, have member or shareholder proposals as advisory for Boards of Directors.

- **Determination on incorporation whether public benefit or member benefit (asset lock).**

  Rationale: Organizations that serve their members only are commonly known as member benefit corporations. These include trade and professional associations, private clubs, and condominium corporations. Organizations that exist to serve the public good are often referenced as public benefit corporations. They include sport and recreation organizations, nonprofit social enterprises, supportive housing as well as all kinds of charities. These two organizational types are identified in the legislation, but the wrong criteria is used to distinguish between them.

Charities under the ONCA are always considered public benefit. The ONCA defines other organizations as qualifying as a public benefit corporation by their source of funding (currently, a minimum of $10,000 in donation or grant revenue) rather than by the purpose of the organization. This is problematic for two reasons. Member benefit corporations, if they receive a small grant, suddenly become a public benefit corporation (with an asset lock and different requirements for financial review) for three years before reverting back to being a member benefit corporation. This is confusing for member benefit organizations and serves no meaningful purpose. Meanwhile, many public benefit organizations, such as a local recreational soccer league that wants to be recognized as a public benefit organization (with an asset lock and different requirements for financial review), cannot qualify because it has not received a $10,000 grant.

It should be the self-identified purpose of the organization, not the source of funding, that distinguishes member benefit organizations from public benefit corporations. It is in the public interest as well as the interest of any given organization to have clarity on corporate status.

- **Allow for optional audits.**

Rationale: Audits are expensive; even "review engagements" (a review process less extensive than an audit) are costly for small organizations. Allowing corporations to pass extraordinary resolutions not to have an audit or a review engagement would allow these corporations to make their funds go further in their communities. An extraordinary resolution required to forego an audit or review engagement safeguards the process and does not eliminate the requirement for the directors to place financial statements before the members at the annual meetings.

Part II. Suggested Amendments to the ONCA

Since 2011, charity and not-for-profit lawyers have had experience working with the CNCA which is similar to the ONCA in many respects. This experience, combined with the feedback from the field ONN has received, enables an in-depth understanding of the legislative changes needed to ensure organizational governance needs are met and the ONCA supports a strong and responsive nonprofit sector.

All references to provisions of the ONCA are to the ONCA as amended in 2017.

1. Clarify use of restated articles of amendment for transition of existing corporations.

Once the ONCA is in effect, many not-for-profit corporations will want to restate their articles to eliminate matters which are no longer required by legislation, or to replace them with the current

version, and to consolidate amendments that have been made over the years. One very desirable change is the ability to change from a fixed board size, which under s.285(1) of the *Corporations Act,* may be changed by special resolution, to a "floating" board size, with a minimum of three and maximum chosen to fit the needs of the corporation.

ONCA s.30 requires articles of amendment to change from a fixed to a floating board, but s.103(1)(h) appears to require articles of amendment as the only apparent way to increase or reduce the size of a fixed board. We expect that there will be a significant number of applications for restated articles, accompanied by applications for articles of amendment to create a different board size or a floating board. This could place an unnecessary extra burden on Service Ontario immediately upon proclamation of the ONCA.

Based on our review of the transition provisions in s.207, we have a number of concerns. It is not clear from s.109(1), which allows the directors to apply for restated articles without requiring member approval, and s.207, that it is possible to obtain restated articles under s.109 without having to amend the articles with the requisite approval by special resolution under s.207(4). S.207(4) appears to deal with two different transitional issues:

- Clause (4)(a) apparently refers to matters which are not deemed by the ONCA to be included in the articles and which would therefore require a special resolution and articles of amendment. Once the articles have been amended, the new provision could be added to restated articles.
- The purpose of clause (4)(b) is not entirely clear. Since it does not refer to articles of amendment, it implies that a corporation with a fixed number of directors in its letters patent or special resolutions might be able to pass a special resolution to establish a minimum and maximum number of directors without having to obtain articles of amendment. If this is the case, once such a special resolution has been passed, it should be possible to obtain restated articles under s.207(5) which include the new board composition. We are not aware of any other provision in letters patent or special resolutions to which clause (4)(b) might apply.

Finally, s.207(5) does refer to section 109 and sets out what may be included in restated articles.

Amendments to ss.109 and 207 will help clarify that it is possible to have an up-to-date set of articles without having to go through a member approval process, unless it is necessary to establish a floating number of directors. S.207(4)(a) would then be limited to amendments to the articles to insert provisions which are not deemed to be in effect by any other provision of the ONCA.

Suggested Amendment

We have several recommendations to address this situation:

1. Amend s.30 similar to OCA s.285(1), so corporations with fixed boards will not have to amend their articles to change the size or go to a floating board size if they do not wish.
2. Amend s.109 by adding at the beginning, "Subject to section 207,";
3. Amend s.207(4)(a) to clarify that articles of amendment are only required if a matter to be included in the articles is not deemed to have been included by another provision of the ONCA; and,
4. Amend s.207(4)(b) to confirm that a corporation may pass a special resolution to change from a fixed to a floating number of directors, that such special resolution is then deemed to be included in the articles, and that such change will come under the provisions of subsection 207(5).

We would be pleased to consult on the specific wording of these amendments, as required. Additionally, some transition guidance may be provided in the regulations to the ONCA, and we would be pleased to provide assistance in reviewing the regulations.

2. **Repeal provisions giving non-voting members voting rights in certain situations.**

- Sections 105(2), 111(3), 116(3) and 118(4) have caused a great deal of confusion in the sector and are unlikely to result in increased participation of members in corporate governance. In fact, they will likely have the opposite effect.

- Section 75(2), which permits a non-voting member to require the corporation's auditor to attend at the annual meeting.

These sections are virtually identical to the corresponding sections of the CNCA, which came into force in 2011, despite considerable opposition from the charity and non-profit sector. Federally-incorporated not-for-profit corporations and their advisors have had nine years of experience with this concept. The result has been the almost complete elimination of any non-voting classes and conversion of former members into "affiliates", "friends", "adherents", etc. Organizations are unwilling to assume the uncertainty and the risk of having non-voting members who may have the ability to vote in certain circumstances. Members, unlike shareholders, do not have a financial stake in the corporation. Retaining voting rights for non-voting members is neither consistent with sector practice nor a useful concept and should be removed.

Suggested amendment

Repeal sections 105(2), 111(3), 116(3) and 118(4).

Amend section 75(2) to delete ", whether or not the member is".

3. No class votes as default; permit articles to include an "opt-in" for class votes.

Sections 105(1), 111(4), 118(5) and 120(3) provide that each class of members has the right to vote separately in respect of the matters covered in them.

Under the CNCA, we have seen an almost universal collapse of classes of voting members into one class to avoid these provisions. Elaborate drafting techniques have been developed to allow corporations to differentiate in the treatment, fees, rights and other aspects of membership. In many cases we have seen a move to a closed membership structure in which the directors are the only members. As noted above, except in very limited circumstances, these voting provisions are a hindrance to democratic member engagement. The ONCA already contemplates the elimination of class votes in certain instances by allowing the articles to contain a provision deleting separate class votes in the case of clauses 105(1) (a) and (e), which would effectively allow the corporation to cancel a membership class without a separate class vote.

The default provided in the Act should be no class votes; however, corporations should be allowed to opt-in to these class voting rules in the articles. The current provisions of the Act could remain as optional provisions, if elected by the corporation. We believe that the vast majority of corporations will be better served by no class votes; therefore, our recommendation is changing the default set by the legislation while allowing corporations to choose class votes.

Suggested amendments

Amend section 105(1) to commence "105 (1) If provided for in the articles, the members of a class or group of members are entitled to vote separately as a class or group ..."

Amend sections 111(4) and 118(5) to commence "*If provided for in the articles,* …"

Amend section 120(3) to commence "(3) Subject to any order of the court made under subsection (5), where an arrangement is approved by members of a corporation and*, if provided for in the articles,* by each applicable class or group of members entitled to vote separately on the arrangement…."

4. Permit delegate voting.

Delegate voting is a useful democratic tool, particularly for organizations with national and regional memberships. It is currently permitted under the Ontario *Corporations Act*.

Suggested Amendment

Amend ONCA to include language similar to section 130 of the Ontario *Corporations Act,* but do not include section 130(3) of that Act which prohibits delegates voting by proxy (not included below):

By-laws respecting delegates
130 (1) The directors of a corporation may pass by-laws providing for,

(a) the division of its members into groups that are composed of territorial groups, common interest groups or both territorial and common interest groups;
(b) the election of some or all of its directors,
(i) by such groups on the basis of the number of members in each group, or
(ii) for the groups in a defined geographical area, by the delegates of such groups meeting together;
(c) the election of delegates and alternative delegates to represent each group on the basis of the number of members in each group;
(d) the number and method of electing delegates;
(e) the holding of meetings of delegates;
(f) the authority of delegates at meetings or providing that a meeting of delegates shall for all purposes be deemed to be and to have all the powers of a meeting of the members;
(g) the holding of meetings of members or delegates territorially or on the basis of common interest.
Confirmation
(2) No by-law passed under subsection (1) is effective until it has been confirmed by at least two-thirds of the votes cast at a general meeting of the members duly called for considering the by-law.
Qualification of delegates
(3) No person shall be elected a delegate who is not a member of the corporation.
Saving
(4) No such by-law shall prohibit members from attending meetings of delegates and participating in the discussions at such meetings.

5. Eliminate confusion on binding effect of member proposals.

Section 56 (1) allows a member entitled to vote at an annual meeting of the members to submit a proposal concerning "any matter that the member proposes to raise at the meeting". There is long-standing authority in the case of both for-profit and non-profit corporations that a vote in favour of a proposal concerning any such matter which is within the sole authority of the board is not binding on the board or the corporation. While such measures may appear on the agenda, any vote taken on them is considered to be "advisory".

In each of the *Canada Business Corporations Act*, Ontario *Business Corporations Act* and the Ontario *Corporations Act* the role and authority of the board of directors is set out in similar language:

CBCA, s.102 (1) and OBCA, s.115 (1): [Subject to any unanimous shareholder agreement,] the directors shall manage, or supervise the management of, the business and affairs of a corporation.

OCA, s.283 (1) The affairs of every corporation shall be managed by a board of directors howsoever designated.

However, the corresponding provision of the ONCA (and also the CNCA), has added an additional qualification:

ONCA s. 21 *Subject to this Act*, the directors of a corporation shall manage or supervise the management of the activities and affairs of the corporation.

CNCA, s.124 *Subject to this Act*, the articles and any unanimous member agreement, the directors shall manage or supervise the management of the activities and affairs of a corporation.

The inclusion of the words "Subject to this Act" at the beginning of section 21 has caused confusion and concern in the sector. We believe that the intention of the drafters of both the CNCA and ONCA was simply to clarify that the powers of the directors are qualified by certain provisions set out in the CNCA and ONCA. However, the addition of this phrase leads to concern that directors' statutory powers could be limited or overridden (in an unprecedented way) by members through a member proposal. This interpretation is not consistent with corporate practice and caselaw. In some cases it may have been a motivating factor in the elimination of members of OCA and CNCA corporations other than the directors.

To eliminate the confusion and provide clarity to the sector and the practitioners, section 56 should be amended to provide that a proposal put forward under it cannot create a binding resolution on a matter that is within the sole jurisdiction of the board.

Suggested Amendment

Amend s.56 by adding the following subsection:

(11) Notwithstanding sub-section (1), a resolution passed under this section shall not bind the corporation unless and to the extent that the subject matter is within the powers reserved to the members under this Act.

6. Determination on incorporation whether public benefit or member benefit.

The reality of the nonprofit sector in Ontario is that there are two types of not-for-profit corporations: those that exist to serve their membership ("member benefit corporations") and those that exist to serve a public good ("public benefit corporations"). Both are contemplated by the ONCA, but, except in the case of charities, the distinction between the two groups is not based

on the nature or purpose of the organization, but rather on the source of funding and level of revenue.

The distinction between the two types of corporation should be made in the articles of incorporation, at the time of incorporation. In the case of transitioning corporations, they would elect in the articles of amendment whether they are a public benefit or a member benefit corporation.

In the case of a public benefit corporation, this selection should be unchangeable during the existence of the corporation (except by court order, or possibly with the consent of the Public Guardian and Trustee pursuant to s.13 of the *Charities Accounting Act*, or a similar provision in the ONCA). This will bring certainty to both types of corporations and provide assurances to donors that funds gifted or transferred to public benefit corporations will stay within the public-benefit sphere.

Suggested Amendments

Amend the definition of "public benefit corporation" in section 1(1) by deleting clause (b) and replacing it with:

(b) a non-charitable corporation which has included in its articles:
(i) a declaration that it is a public benefit corporation; and
(b) a distribution provision set out in s.167(1)(d)(i);

Amend section 1(2) (Deeming re public benefit corporation) by deleting it in its entirety and replacing it with the following.

> **Despite the definition of "public benefit corporation" in subsection (1), if a non-charitable corporation has a valid provision in its letters patent, supplementary letters patent, by-laws or any special resolution that does not permit the distribution of the corporation's remaining property on winding up or dissolution to its members, that corporation is deemed to be a public benefit corporation, unless its articles are amended in accordance with subsection 207(4).**

Repeal (or do not proclaim) section 167(6).

Amend section 103(1)(j) by inserting at the beginning "subject to clause 103(1)(j.1),"

Add new section 103(1)(j.1)

- **change from a non-public benefit corporation to a public benefit corporation; or**
- **subject to sub-section 103(5), change from a public benefit corporation to a non-public benefit corporation;**

Add new section 103(5): **A change pursuant to clause 103(1)(j.1)(ii) must be approved by order of the Court or pursuant to s.13 of the *Charities Accounting Act*.**

7. Allow for optional audits.

Financial audits can be a significant burden on a not-for-profit corporation and are not required in every situation. The low financial thresholds for an audit and the difficulty of obtaining member approval for reduction to review engagement or dispensing with an audit under the CNCA has led to a significant degree of non-compliance. Despite the somewhat higher threshold levels and greater ease of access to member approvals under the ONCA, we foresee that there will be significant non-compliance among smaller organizations.

The distinction between public benefit and non-public benefit corporations is also problematic. Tax and charity regulators do not require audited financial statements and have sufficient investigative powers to deal with corporations which have improperly reported their financial affairs. In addition, many organizations which receive external funding are required by the grantor to provide audited financial statements. Boards of directors and members who want to have audits, for fundraising purposes, as protection against legal claims, or simply because it is appropriate in the circumstances, can arrange to have them.

To allow for maximum flexibility and efficient use of funds, members should be able to dispense with the audit requirement by extraordinary resolution. This ability should not be dependent on the corporation's annual revenues; a requirement which has caused confusion under the CNCA, and generally resulted in either unnecessary accounting fees or non-compliance. As the members must choose to dispense with an audit or review engagement by extraordinary resolution, the control mechanisms and financial accountability is preserved.

Suggested Amendments

Delete section 76(2) and replace section 76(1) as follows:

76 (1) 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; 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.