Bill 85 – *Companies Statute Law Amendment Act*, 2013

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Submitted to: Ministry of Consumer Services

Submitted by: The Ontario Bar Association, Business Law and Charity and Not-for-Profit Law Sections

ONTARIO BAR ASSOCIATION
A Branch of the Canadian Bar Association

L'ASSOCIATION DU BARREAU DE L'ONTARIO
Une division de l'Association du Barreau canadien

Introduction

The Ontario Bar Association ("**OBA**") appreciates the opportunity to provide comments to the Ministry of Consumer Services ("**the Ministry**") in respect of Bill 85, *Companies Statute Law Amendment Act, 2013* ("**Bill 85**").

The OBA

Established in 1907, the OBA is the largest voluntary legal association in Ontario and represents approximately 16,000 lawyers, judges, law professors and law students. The OBA is pleased to analyze and assist government with dozens of legislative and policy initiatives each year - both in the interest of the profession and in the interest of the public.

This submission was jointly prepared by the OBA Business Law Section and the OBA Charity and Not-for-Profit Section, both of which contributed to the OBA submission on Bill 65, *Not-for-Profit Corporations Act*, 2010.

Members of the OBA Business Law Section have worked closely with the Ministry and its federal counterpart on various business law reform initiatives, including the *Canada Not-for-Profit Corporations Act*, the Ontario *Business Corporations Act*, and the *Canada Business Corporations Act*. Members of the OBA Charity and Not-for-Profit Law Section include lawyers who represent the widest possible range of charitable and other NFP organizations, who advise boards, management and membership groups on corporate, tax, fund-raising and other regulatory issues, and who have worked with the provincial and federal governments on legislative reform affecting the sector.

Overview

The OBA is pleased to make the following submission, which relates only to the provisions of Schedule 7 to Bill 85 proposing amendments to the Ontario *Not-For-Profit Corporations Act, 2010* ("**ONCA**").

In general the OBA supports the objectives and contents of Schedule 7 and is pleased that it addresses a number of issues raised in response to the passage of the ONCA. In this submission, we wish to address several issues raised by Bill 85 which, in our opinion, require clarification in order to ensure that they achieve their intended purpose.

Specific Comments

1. **By-law Amendments**

Subsection 17(1) of the ONCA refers to clause 103(1)(j). Clause 103(1)(j) requires a special resolution to amend the articles to change to whom the property remaining on liquidation or dissolution (after discharge or payment of any liabilities of the corporation) is to be distributed. We submit that this reference is incorrect and that the correct reference is probably to clause 103(1)(k) instead. A summary of our reasons follows:

(a) The subject matter of clause 103(1)(j) would not be dealt with in the by-laws. See, in particular, ONCA, sub-clauses 150(1)(b)(ii) and 167(1)(d)(ii). Hence, the reference in subsection 17(1) to clause 103(1)(j) appears to be a non-sequitur.

(b) Like clauses 103(1)(g) (transfer of membership interests) and (l) (absentee voting by members), clause 103(1)(k) (manner of giving notice to members) deals with subject matter that concerns members' rights and that would be included in the by-laws. Arguably, directors should not unilaterally change the rules on giving notice to members without first obtaining approval of the members.

We recommend that subsection 17(1) of the ONCA be amended to refer to clause 103(1)(k) instead of clause 103(1)(j).

2. **Director's Consent**

Subsection 97(1) of the ONCA is to be amended to provide that the director's written consent required pursuant to subsection 24(8) of the ONCA must be in an "approved" form. The equivalent provision in the Ontario *Business Corporations Act* ("**OBCA**") (subsection 119(9)), is also being amended in Schedule 1 of Bill 85. However, under the proposed amendment to the OBCA, there is no requirement that the consent be in an "approved" form.

The OBA agrees that the consent of the first directors should be in an approved form, as it is in subsection 5(2) of the OBCA. However, in the OBCA, first directors and incorporators are treated differently from individuals who are subsequently elected or appointed as directors.

Many not-for-profit corporations require their directors to sign consents, not just to act as directors, but for other reasons as well, such as to confirm their qualifications, to consent to electronic participation in meetings, to agree to receive notices by email, to agree to be bound by a Code of Ethics, etc. However, with respect to subsequent directors, the approved form should not be mandatory. A suggested form of consent could be provided, but we recommend that the prescribed contents of the consent should be set out in regulations and that any consent form which contains the prescribed information should be permitted under this section. This change would make it

possible for those corporations which do not wish to have multiple consent forms to prepare their own consent forms containing any additional information and matters they require. It also provides for the harmonization of the OBCA and the ONCA: the rules can be applied and interpreted in the same manner.

3. **Transitional Provisions**

In general, the proposed new section 207 of the ONCA addresses many of the issues raised with respect to the existing provision. However, a number of new issues are raised by the proposed section 207:

(a) Expiry of Grace Period

Clause 207(1)(a) is confusing. If the articles or by-laws of a corporation are amended to conform to the ONCA, then, by its express terms, there is no longer a need for an override provision. Therefore, to avoid any potential uncertainty, we recommend that subsection (a) be deleted and subsection 207(1) be revised to read as follows:

> 207. (1) Any provision in letters patent or other instrument by which a corporation was incorporated under a predecessor of this Act, or any amendments to such instrument, or any provision in a corporation's supplementary letters patent, by-laws or special resolution that was valid immediately before the day this section comes into force and that is not in conformity with this Act continues to be valid until the third anniversary of the day this section comes into force.

Further, the language of clause 207(1)(a) is capable of being interpreted as terminating the three-year grace period at the start of the day on which the corporation amends a provision to bring it into conformity with the ONCA. If this interpretation prevails, then the ONCA will override the non-conforming provisions, rather than permitting their use. New subsection 207(1) reads as follows:

> 207. (1) Any provision in letters patent or other instrument by which a corporation was incorporated under a predecessor of this Act, or any amendments to such instrument, or any provision in a corporation's supplementary letters patent, by-laws or special resolution that was valid immediately before the day this section comes into force and that is not in conformity with this Act continues to be valid and in effect until the earlier of,
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> (a) the day the provision is amended by the corporation to bring it into conformity with this Act; and
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> (b) the third anniversary of the day this section comes into force.

The use of the term "the day the provision is amended" can be interpreted to mean that the non-conforming provision in a corporation's letters patent, by-laws or special resolutions ceases to be in

effect at the commencement of the day on which it is amended by the corporation to bring it into conformity with the ONCA, regardless of the particular time of the day at which the amendment is approved by the directors and members of the corporation or a certificate of amendment is issued by the Director under the ONCA. It is then arguable that the provisions of the ONCA relating to class votes, as well as other relevant provisions of the ONCA, may apply to the approval of the amendment.

(b) Subsection 207(1) – Class Votes

In many, if not most cases, it is not the intention of corporations with multiple classes of members to have separate class voting but their letters patent and/or by-laws do not specifically state that to be the case since it is not mandated by the *Corporations Act* (the "**OCA**"). As such, their letters patent and/or by-laws are not "not in conformity with" the ONCA and therefore, by virtue of subsection 207(1) as currently drafted, it appears that section 105, subsection 111(4) and subsection 118(5) of the ONCA, providing for separate class votes, will come into effect immediately if a corporation has more than one class of voting members unless the letters patent or by-laws of a corporation unequivocally state that different classes or groups of members will vote as one, rather than as separate classes. Many existing corporations are scrambling to amend their by-laws prior to the proclamation of the ONCA to collapse all voting classes into one, or to specifically prohibit separate class votes. We consider this to be a significant and unnecessary cost to the not-for-profit sector.

One reason that not-for-profit corporations need time to transition to the class voting rules is to ensure that they have developed a proper governance structure based on the corporation's governance objects while at the same time complying with the provisions of the ONCA. For example, many organizations have multiple classes of membership, including various types of youth memberships. This is particularly the case with sports associations, arts organizations, and other organizations geared toward children and youth. In many of these organizations, children and youth who participate in the activities of the organization (for example, children who play hockey) are considered non-voting youth members. It was never intended that these constituents be provided with participation in the governance of the organization. Minors, at law, are not able to contract. It is arguable that if minors are given the opportunity to vote separately as a class, the vote and possibly the decision as a result of the vote would be held to be invalid. Therefore, the organizations need to be able to smoothly transition to the ONCA after having determined the governance structure best suited for the organization.

It is recognized that class voting is a fundamental right to be given to members under the ONCA. However, not-for-profit corporations incorporated under Part III of the OCA did not need to consider such a right in the past and have developed their governance structures accordingly. This is a significant departure from business corporations incorporated under Part II of the OCA. Class voting was always part of the OCA. For example, subsection 34(4) of the OCA provides that if an

application for supplementary letters patent is to affect the rights attaching to a class of preference shares or to create preference shares with priority over an existing class of preference shares then the affected class has the right to vote separately as a class.[1] Class voting was entrenched in the OCA in respect of business corporations and did not need to be addressed when developing the transition rules from the OCA to the OBCA; this is not the case for not-for-profit corporations. Therefore, a transition plan needs to be developed that takes into consideration the governance structure of not-for-profit corporations with multiple class structures, based upon the rules applicable to those not-for-profit corporations under the OCA, while at the same time allowing not-for-profit corporations time to modify their structures in order to conform to the ONCA. The class voting rules should only become applicable once the transition is complete.

For the foregoing reasons, we recommend the addition to subsection 207(1), or elsewhere in section 207, a provision to the effect that:

> If a corporation has two or more classes or groups of members, the provisions of sections 105, 111(4) and 118(5) shall not apply to such corporation if its letters patent or other instrument by which the corporation was incorporated under a predecessor of this Act, or any amendments to such instrument, or any provision in the corporation's supplementary letters patent, or by-laws do not specifically provide for each class or group to vote separately as a class or group until the earlier of
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> (a) the time immediately following the amendment to any provision in any of such aforementioned documents to bring the corporation into conformity with this Act, or the date upon which the Director endorses a certificate of amendment according to section 107; or
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> (b) the third anniversary of the day this section comes into force.

In our view, the above provision will allow not-for-profit corporations to deal with these fundamental governance issues during the transition period, while recognizing the fundamental rights of members to participate in decisions about their rights once the transition has been completed, either through positive actions on the part of the not-for-profit corporations, or the expiry of the three year transition period.

(c) Subsection 207(6) – Invalid Provisions in By-laws or Special Resolutions

The Explanatory Note to Bill 85 does not set out the reasons for introducing subsection 207(6). In our submission, the provision is both confusing and appears to contradict the intent and effect of

[1] OCA, ss. 34(4) and (5).

subsection 207(5). If this section is passed, then on the expiry of the three year transition period there could be serious problems for corporations which have not filed articles of amendment to move otherwise compliant provisions from the by-laws into the articles. The practical implication of subsection 207(6) is that all OCA corporations would have to file articles of amendment in order to avoid having these required provisions (which are very important governance provisions) become invalid. While we do not yet know what items will be required to be contained in the articles, we assume that, at a minimum, the number of directors and the classes of members must be included. The consequences of subsection 207(6) on these provisions would be as follows:

(i) Number of Directors**:** Under the OCA corporations will have originally set the number of directors under their letters patent by virtue of the number of incorporators. However, in a great many cases that number has been changed by special resolutions pursuant to subsection 285(1) of the OCA. Proposed ONCA subsection 207(6) will make these special resolutions "invalid" at the expiry of the three year transition period, unless the articles have been amended to increase the board to the same size as set out in the special resolutions. If no articles are filed, we presume the authorized size of the board will default to the number of incorporators set out in the letters patent. It will then be difficult, if not impossible, to determine who are the directors of the corporation, for the purpose of holding a valid meeting.

The OBCA dealt with a similar issue when it was amended.

In 1970, section 124 of the OBCA provided that a corporation could change the number of its directors by special by-law[2]. In 1982, section 125 stated that the number of directors within the range set out in the articles could be increased or decreased by special resolution[3]. In 1986, however, section 125 was amended to add subsection (1a) to take into consideration an increase or decrease in the number of directors by special by-law under a predecessor of the Act. The amendment also contemplated a situation where no resolution had been passed and reads as follows:

> (1a) Where a corporation has increased or decreased the number of directors by special by-law under a predecessor of this Act, the special by-law shall be deemed to constitute an amendment to its articles.
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> . . . . . .

[2] R.S.O. 1970, C. 53, s. 124.
[3] R.S.O. 1980, C. 54, s. 122.

> (2a) Where no resolution has been passed under subsection (2), the number of directors of the corporation shall be the number of directors named in its articles.[4]

Subsection 125(1a) remains in the current OBCA as subsection 125(2) which provides:

> Where a corporation has increased or decreased the number of directors by special by-law under a predecessor of this Act, the special by-law shall be deemed to constitute an amendment to its articles.

A similar provision amending subsection 207(5), substituting "resolution" for "by-law", would resolve this problem for all existing not-for-profit corporations. In addition, it is conceivable that a corporation may never have passed a special resolution to change the number of directors identified in its letters patent and so subsection 125(2a) of the 1986 OBCA amendment could also be added to subsection 207(5) of the ONCA to address this type of a situation. Since it speaks in the past tense and since any further change to the size of the board would require articles of amendment, the addition of this language would mitigate one of the problems caused by proposed subsection 207(6).

(ii) Classes or Groups of Members**:** Although the regulations which will specify the contents of articles of incorporation have yet to be published, it appears by virtue of the wording of section 48 of the ONCA, that the classes or groups of members of a corporation must be set out in the articles.

Currently, the classes or groups of members for corporations incorporated under Part III of the OCA are set out in a corporation's by-laws, together with the rights, privileges, restrictions and conditions attaching to such classes that are not mandatory provisions set out in the OCA itself. This is a significant difference with business corporations that were incorporated under Part II of the OCA because the classes of shares together with the rights, privileges, restrictions and conditions attaching to those shares were always required to be set out in the letters patent and as a consequence, this issue was not a consideration when developing the transition rules to move corporations from the OCA to the OBCA.

However, for not-for-profit corporations incorporated under Part III of the OCA, the transition of classes of members requires careful consideration to ensure that the classes of members end up in the articles, whether it is by deeming the articles to be amended (such as is the proposal for the number of directors) or in some other fashion.

As with the number of directors discussed above, proposed ONCA subsection 207(6) will make the classes of members set out in the by-laws "invalid" at the expiry of the three year transition period,

[4] S.O. 1986, C. 57, s. 11.

unless the articles have been amended to include the authorized classes of members. If no articles are filed, it will throw into question the entire membership structure of the corporation. Since presumably the ONCA is going to split the classes of and conditions for being members between the articles and the by-laws, it is imperative that the classes of members are dealt with in such a way that the transition to the ONCA is fluid for not-for-profit corporations. A further amendment to subsection 207(5) to provide that otherwise conforming provisions in the by-laws or special resolutions of a corporation are deemed to have been included in the articles, similar to the proposed amendment set out above in respect of the number of directors, would be helpful to address this specific issue. Otherwise, every not-for-profit corporation will be required to file articles of amendment which will be a significant cost to the sector.

It is possible that other issues of a similar nature may be identified when the regulations to the ONCA are published and it becomes clear which provisions must be contained in the articles. The OBA recommends the deletion of proposed subsection 207(6) from Bill 85. If there is a problem or ambiguity in some provision of the ONCA which this subsection was intended to correct, then in our submission it should be redrafted so as to deal specifically with that issue in such a way that it does not unintentionally eliminate membership classes.

Conclusion

Once again, the OBA appreciates the opportunity to provide this submission on Bill 85 pertaining to proposed amendments to the Ontario *Not-For-Profit Corporations Act, 2010*.