

Community Dispatch

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Revising the Ontario *Corporations Act*: Part 2 of 3 – Boards, Directors and Officers

*The Ontario Ministry of Government and Consumer Services is conducting consultations regarding reform of the Ontario Corporations Act, the legislation that governs the creation, governance, and dissolution of Ontario not-for-profit corporations. In Part 1 of this series on proposed reforms to the Act, we provided background on the consultations and the Ontario Nonprofit Network (ONN) Expert Working Group, which is providing assistance to the nonprofit sector in deliberating on the issues, as well as a summary of the Ministry's Consultation Paper #1 and the ONN's response. Among the ONN recommendations is that **new, separate legislation is required to recognize and address the unique qualities, functions and purposes of Ontario's public benefit sector, distinct from legislation governing other forms of non-profits** (ONN 2008c, 3).*

Parts 2 and 3 of this Community Dispatch series summarize the issues covered in Consultation Papers #2 and #3, respectively, and the ONN's response. More comprehensive discussion is contained in the Ministry's Consultation Papers, and the ONN's full briefing papers.

*We encourage all nonprofits to engage in this process and to submit their own comments to the Ministry of Government and Consumer Services. **The deadline for submissions is May 31, 2008.** The ONN briefing papers contain directions for submitting your response to the Ministry. The Ministry consultation papers, ONN briefs, as well as submissions by Imagine Canada and the United Ways of Ontario Council are found at <http://ontariononprofitnetwork.ca/resources/all>. Additional explanation and discussion on many of these issues are in the Supplementary Materials at www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html*

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Consultation Paper #2 recognizes that many of the provisions in the Corporations Act related to directors and officers may be outdated, and lack provisions common in other corporate statutes that would provide flexibility. Some matters related to boards, such as whether the revised Act should include default by-laws, and measures to prevent self-perpetuating boards, are covered in Consultation Paper #3.

ISSUE: Number of Directors

Current provisions stipulate that an organization have a fixed number of directors (with a minimum of three), and that a change to the number of directors requires a special resolution of members. The consultation is examining whether a minimum should be required and, if so, what the minimum should be, possibly depending on the nature of the organization (MGS 2007b, 6-7).

ONN Recommendation: The ONN recommends that, regardless of the type of not-for-profit, organizations be able to specify a minimum (no less than three) and maximum number of directors, rather than a fixed number, which could be changed to suit changing realities through amendments to the corporation's articles (ONN 2008b, 3).

ISSUE: Qualifications of Directors

Current provisions require that a director be a member of the corporation, eighteen years of age or older, and not an undischarged bankrupt. The consultation is examining the membership requirement and whether other qualifications should be required: as an example, the *Ontario Business Corporations Act* stipulates that directors not be 'incapable' (MGS 2007b, 8-9).

ONN Recommendation: The ONN recommends that “only individuals (as opposed to other organizations) should qualify to be directors. Directors should not be under 18 years of age, bankrupt, or ‘incapable,’ “ but notes: “ We agree with the note of caution in this regard from the United Ways of Ontario’s response to *Consultation Paper #2* – “If a person was found to be ‘incapable’ in the past but is no longer deemed to be so, are they now eligible to serve as a director? ...if not, we would have concerns about unreasonable impediments to, for example, consumer/ survivors of mental health services on non-profit boards” (ONN 2008b, 3).

The ONN also states that legislation should not require that directors be members of the corporation, and that at least two of the required three directors should not be officers or employees of the corporation.

ISSUE: Term of Office

The *Act* does not stipulate a maximum length of term for directors. The consultation is examining whether Ontario’s *Corporations Act* should include a maximum term of office, as is the case in some other jurisdictions (MGS 2007b, 10). Additional discussion is contained in *Consultation Paper #3* (MGCS 2008, 33-36).

ONN Recommendation: The ONN recommends that the maximum time for a director to remain in office before an election is required should be three years, unless a lesser term is specified in the organization’s by-laws, and that there should be no maximum limit on consecutive terms of office, unless restricted by the organization’s by-laws (ONN 2008b, 4).

ISSUE: Directors' Meetings

The *Act* makes provisions only on matters of quorum, place and electronic or telephone meetings. The consultation is examining whether there should also be stipulations regarding notice and resolutions in lieu of a meeting, i.e., written unanimous resolutions that allow directors to transact business without meeting (MGS 2007b, 11-13).

ONN Recommendation: The ONN recommends that “the reformed legislation should permit meetings of directors to be called on the notice provisions required in the organization’s by-laws” and that directors “may waive the notice of a meeting, and attendance at a meeting fulfills the requirements of waiving notice.” It also recommends that the reformed *Act* “should provide for a resolution to be signed by all directors in order to be considered as a resolution passed at a meeting of directors” (ONN 2008b, 4).

ISSUE: Resignation and Removal of Directors

Currently, corporations may remove a director prior to the expiry of the term by a two-thirds vote (selecting a replacement director for the remainder of the term requires a majority vote). In case of a resignation, directors may, if there is a quorum, fill the vacancy for the remainder of the term of office. If there is no quorum, a members’ meeting is required to fill the vacancy. The consultation is examining whether it should be permitted that directors be removed through an ordinary resolution (i.e., majority of votes cast, rather than two-thirds), the rules regarding their replacement, as well as whether certain rights should be allowed to directors who resign or are removed, such as the right to submit a written statement to the corporation (MGS 2007b, 14-15).

ONN Recommendation: The ONN recommends that organizations be allowed to remove directors by majority vote of the class of members that elected the director, and that “if a replacement director is not elected by the members (or class of members) at the time of removal, the remaining directors should decide whether to replace the resigned director before the next election of directors.” It also recommends that directors be permitted to resign at any time and submit written reasons for their resignation, but that the minimum required number of directors not be allowed to resign until their successors have been elected/appointed (ONN 2008b, 4).

ISSUE: Officers

Currently, the *Act* requires only that a president be elected and a secretary be appointed. By a special resolution, a corporation may elect a chair of the board to be assigned any or all of the duties of a president, and additional officers may be appointed. Officers need not be directors or members, with the exception of the president and chair, who must be both. The consultation is examining whether the *Act* should provide for the appointment of other specific officers, and whether officers should be required to be directors (MGS 2007b, 16).

ONN Recommendation: The ONN recommends that a corporation have, at minimum, a president (who is also a director) and a treasurer (ONN 2008b, 4).

Consultation Paper #2 notes that the *Corporations Act* “lacks provisions that set out the duty of care, standard of care, and defences against liability applicable to directors and officers. Directors may be personally liable to account for losses from breach of fiduciary duties, conflict of interest, fraud, negligence, or criminal behaviour. Directors may also be personally liable for unpaid wages, taxes, and pension contributions owing by a corporation when the corporation becomes insolvent” (MGS 2007b, 23). The following issues deal with this area of concern.

ISSUE: Duty of Care and Loyalty

Consultation Paper #2 notes that, in actual legal application, what constitutes standard of care may differ between different directors, such that, for example, a director who has legal training may be held to a higher standard than one who does not (MGCS 2007b, 17).

Recognizing the difficulty in recruiting and retaining qualified directors and officers of not-for-profit corporations, the disincentive that such lack of clarity regarding liability provides, and the suggestion that it is inherently unfair to allow those who volunteer their time in order to provide a valuable public service to face liability, the consultation asks a number of questions regarding how this issue can be addressed.

ONN Recommendation: The ONN recommends that the revised *Act* “require the same duty of care and loyalty required of directors of for-profit organizations: to act honestly and in good faith, with a view to the best interests of the corporation; and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. This objective test is more appropriate than a test that involves subjectivity and a higher standard of care required of some directors” (ONN 2008b, 5).

ISSUE: Due Diligence Defence

A due diligence defence “would restrict liability to circumstances where the director did not perform as he or she could reasonably have been expected to perform” (MGS 2007b, 19). Currently, the defence exists in common law, but the inclusion of such a provision in a revised *Corporations Act* would clarify that it is also specifically applicable to directors of not-for-profit corporations (MGS 2007b, 19-20).

ONN Recommendation: The ONN recommends that the reformed *Act* “mirror other legislation, including the *Ontario Business Corporations Act*, that absolves directors from liability if they relied, in good faith, on information from experts such as accountant, lawyers, engineers, appraisers and others, whose profession confers credibility. Such information and advice can also serve as a defence if it comes from staff of the organizations” (ONN 2008b, 5).

ISSUE: Indemnification and Insurance

Currently, the *Act* allows not-for-profit corporations to indemnify their directors and officers for costs, charges and expenses arising out of legal actions, and to purchase liability insurance. However, a charitable corporation may purchase insurance for its directors only if it complies with the *Charities Accounting Act* (or regulation), or obtains a court order authorizing the purchase. The consultation is asking whether not-for-profit corporations should be permitted to indemnify and/or purchase liability insurance for their officers and directors (MGS 2007b, 20-21).

ONN Recommendation: The ONN recommends that not-for-profit organizations continue to be allowed to purchase liability insurance to cover the indemnification of people acting in their capacity of directors or officers (ONN, 2008b, 5).

ISSUE: Limiting Liabilities of Directors and Officers

Currently, the *Act* contains no provisions capping the liabilities of directors and officers. The consultation is examining whether directors and officers should “be shielded, in whole or in part, from personal liability, or provided with caps on personal liability” (MGS 2007b, 24) and whether distinction should be made between those who are remunerated and those who serve on a volunteer basis. One example noted is that used in the *Saskatchewan Non-Profit Corporations Act*, under which “directors and officers are not personally liable in any civil action that arises out of an act or omission connected with the responsibilities of a director or officer, as long as he or she acted in good faith. The general immunity does not extend to loss caused by fraud or criminal misconduct. Directors remain liable for certain statutory liabilities” (MGS 2007b, 22-23).

ONN Recommendation: The ONN recommends that the Ontario follow the Saskatchewan model (ONN 2008b, 5).

ISSUE: Conflict of Interest

Currently, the *Act* provides a process for directors to disclose direct or indirect interest in a contract with the corporation, and stipulates that a director (but not an officer) be liable to a fine if the conflict of interest makes the contract subject to being declared void. The consultation is examining whether conflict of interest provisions should be amended; should be applied not only to contracts but to other matters as well; and should apply to both directors and officers (MGS 2007b, 25-27).

ONN Recommendation: The ONN recommends that “the reformed *Act* should mirror other frameworks, such as the *Saskatchewan Non-*

Profit Corporations Act, in defining conflict of interest on the part of directors and officers, and requiring certain action in those cases. A director or officer should be required to disclose, in writing, the fact that he or she is party to a contract, has a material interest in a contract, or has an interest in any other material transaction of the corporation. Furthermore, directors or officers with a conflict of interest should not be permitted to vote on resolutions dealing with such transactions” (ONN 2008b, 5).

References

Ministry of Government Services (MGS, 2007a). *Consultation paper: Modernization of the legal framework governing Ontario not-for-profit corporations*. [Toronto]: May 7, 2007. www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html

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Ministry of Government and Consumer Services (MGCS, 2007c). *Supplementary materials to May 7, 2007 consultation paper: Modernization of the legal framework governing Ontario not-for-profit corporations*. [Toronto: Dec 2007]. www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html

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Ontario Nonprofit Network Expert Working Group (ONN, 2008a). *Revising the Corporations Act: A brief to the sector from the Ontario Nonprofit Network Expert Working Group regarding Consultation Paper #1*. <http://ontariononprofitnetwork.ca/resources/all>

Ontario Nonprofit Network Expert Working Group (ONN, 2008b). *Revising the Corporations Act: A brief to the sector from the Ontario Nonprofit Network Expert Working Group regarding Consultation Paper #2.* <http://ontariononprofitnetwork.ca/resources/all>

Ontario Nonprofit Network Expert Working Group (ONN, 2008c). *Revising the Corporations Act: A brief to the sector from the Ontario Nonprofit Network Expert Working Group regarding Consultation Paper #3.* <http://ontariononprofitnetwork.ca/resources/all>

• Consultation Paper #1 (May 7, 2007)	Consultation Paper #2 (August 22, 2007)	Consultation Paper #3 (February 28, 2008)
<ul style="list-style-type: none"> • 1. Incorporation "as of right"? • 2. Structure of the new Act • 3. Definition of a nonprofit corporation <ul style="list-style-type: none"> • 3.1 Not-for-Profit Purpose • 3.2 Non-distribution Constraint • 4. Classification system • 5. Corporate powers and capacities • 6. Other issues (in brief): <ul style="list-style-type: none"> • 6.1 Director and officer liability • 6.2 Financial Disclosure • 6.3 Members' Remedies 	<ol style="list-style-type: none"> 1. Board structure <ol style="list-style-type: none"> 1.1 Number of Directors 1.2 Qualification of Directors 2. Term of office 3. Directors' meetings <ol style="list-style-type: none"> 3.1 Notice 3.2 Resolution in lieu of Meeting 4. Resignation and removal of directors 5. Officers 6. Directors' and officers' liability <ol style="list-style-type: none"> 6.1 Duty of care and loyalty 6.2 Due diligence defence 6.3 Indemnification and insurance 6.4 Immunity from liability 7. Conflict of Interest 	<p style="text-align: center;">MEMBERSHIP</p> <ol style="list-style-type: none"> 1. Membership lists 2. Members' voting agreements 3. Quorum 4. Transferability of membership interest 5. Termination and disciplinary matters 6. Remedies <ol style="list-style-type: none"> (a) compliance order; (b) oppression; (c) derivative action; (d) dissent and appraisal. <p style="text-align: center;">CORPORATE FINANCE</p> <ol style="list-style-type: none"> 1. Financial review in lieu of an audit 2. Financial disclosure 3. Borrowing and debt issuance <p style="text-align: center;">OTHER</p> <ol style="list-style-type: none"> 1. Standard by-laws 2. Self-perpetuating board



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