

## Bill C-62 (Canada Not-for-profit Corporations Act)

Canadian not-for-profit (“NFP”) corporate law may soon leap forward 89 years.

### 1. Background

Canadian federal NFP corporations have long suffered from an antiquated, inconsistent corporate regime that leaves many gaps and is difficult to navigate. On June 13, 2008, Bill C-62 (the **Canada Not-for-profit Corporations Act**) received first reading in Parliament. Bill C-62 will replace Part II of the **Canada Corporations Act** (“CCA”) – last revised in 1919. It would also give share capital corporations created by special Acts of Parliament and subject to Part IV of the CCA the opportunity to apply for a continuance under the **Canada Business Corporations Act** (“CBCA”).

In brief, Bill C-62 will establish a comprehensive framework for the governance of federal NFP corporations and other corporations without share capital, closely modelled on the CBCA, taking into account the unique character of NFP corporations.

Bill C-62 picks up where its predecessor, Bill C-21 left off. Bill C-21 died on the order paper in 2005 when Parliament was dissolved for the January 2006 general federal election.

### 2. Distinction Between Soliciting and Non-Soliciting Corporations

Like its predecessor, Bill C-62 separates corporations into soliciting and non-soliciting corporations. Non-soliciting corporations are the residual category.

The definition of “soliciting corporation” in Bill C-62 is significantly sharper than it was under Bill C-21. Under Bill C-62, the definition is based on whether receipts from a short-list of public sources in the previous three fiscal years are in excess of \$10,000 in aggregate. In effect, this low threshold introduces a de minimus exemption designed to prevent the inadvertent capture of corporations that do not receive significant public funds.

The funding sources that determine whether a corporation is “soliciting” are: (a) public donors (i.e. more specifically, donors who are not members, directors, officers or employees of the corporation at the time of the funding request or persons who are related by blood or marriage thereto); (b) governments or governmental agencies (federal, provincial or municipal); (c) other soliciting corporations; or (d) other entities that received funds in excess of \$10,000 in the previous three years from these same sources. A donation from a person who is not an existing member at the time of the

funding request but becomes a member as a result of paying a donation would be included in determining the threshold, whereas a donation from an already subsisting member does not count in determining the threshold. Unlike what would have been the case under Bill C-21, mere solicitations to the public (without actually receiving funds) would not make the corporation a “soliciting corporation”.

### 3. Tighter Regulation of Soliciting Corporations

In general terms and not surprisingly, soliciting corporations will be regulated more closely than non-soliciting corporations. Most importantly, upon the liquidation of a soliciting corporation (and certain other corporations including corporations that are registered charities under the **Income Tax Act** (Canada) (the “Tax Act”)), any residual assets (after satisfying all liabilities and returning property to a donor who gave the property on condition that it would be returned on dissolution) are to be distributed exclusively to one or more “qualified donees”, defined as such under the Tax Act. Qualified donees under the Tax Act include, for example, registered charities, certain foreign charitable organizations, registered Canadian amateur athletic associations, the Crown (federal, provincial and municipal), prescribed foreign universities, the UN and its agencies.

All other corporations are free to provide in their articles for the distribution of residual property upon liquidation to qualified donees or anyone else. In the absence of specific provisions, the default rule for these latter corporations is that, on liquidation, the residual assets are to be distributed equally to members on a per capita basis.

Other notable differences between soliciting and non-soliciting corporations are:

- (a) soliciting corporations must have a minimum of three directors, whereas non-soliciting corporations only need one director;
- (b) soliciting corporations must have a minimum of two non-management directors, whereas a non-

soliciting corporation’s board could consist entirely of management (i.e. officers and employees);

- (c) soliciting corporations are required to file their annual financial statements with the Director appointed under the Act (the “Director”) where they will be available to any member of the public (similar to the requirement that CBCA distributing corporations file their annual financial statements with the CBCA Director), whereas non-soliciting corporations are only required to circulate their financial statements or a summary thereof to members in advance of the annual meeting or, alternatively, may provide in their by-laws a mechanism whereby the corporation simply notifies members in advance of the annual meeting that a copy of the financial statements or a summary thereof will be provided to those members who request them;
- (d) members of a non-soliciting corporation may enter into a unanimous member agreement (“UMA”) or the sole member thereof may enter into a unanimous member declaration (“UMD”), whereas members of a soliciting corporation may not enter into a UMA or UMD. Among other things, a UMA or UMD may be used to transfer some or all board authorities, powers and liabilities to the members; and
- (e) exemptions for waiving the audit and the appointment of a public accountant are much more limited for soliciting corporations than for non-soliciting corporations.

### 4. Public Accountants and Audits

Bill C-62 provides that, as a general rule, an NFP corporation must appoint an independent public accountant (“PA”) and have an annual audit. However, in recognition that, for smaller NFP corporations, the costs of appointing a PA and having an audit may outweigh the incremental benefits, various exemptions are available in Bill C-62 based primarily on aggregate revenue in the last completed financial period (“FY”) of the corporation and annual membership approval. These exemptions are set out in the following table.

Corporation	Annual Revenues ("AR") for Previous FY	Public Accountant ("PA")	Audit Engagement/Review Engagement/Compilation
<b>Soliciting</b>	AR < \$50,000.01	PA not required if members entitled to vote at an annual meeting unanimously consent. Waiver must be annual	Compilation applies if no PA. If PA appointed, review engagement applies unless members pass an ordinary resolution (i.e. not less than a simple majority voting approval) requiring an audit
	\$50,000 < AR < \$250,000.01	Appointment of PA required unless Director is satisfied that waiver would not be prejudicial to public interest	Audit may be waived in favour of review engagement by special resolution of members (i.e. not less than 2/3rds voting approval) unless appointment of PA also waived (in which case compilation report applies)
	\$250,000 < AR	Same as above	Audit required unless Director is satisfied that waiver is not prejudicial to public interest, in which case review engagement required. If appointment of PA also waived by Director, compilation report applies
<b>Non-soliciting</b>	AR < \$1,000,000.01	PA not required if members entitled to vote at an annual meeting unanimously consent. Waiver must be annual	Compilation report applies if no PA. If PA appointed, review engagement applies unless members pass ordinary resolution requiring an audit
	\$1,000,000 < AR	PA required	Audit required

**5. Other Modernizing Rules Applicable to All Federal NFP Corporations**

Bill C-62 has the following attractive features for various NFP constituencies:

- (a) For directors and officers ("D&O"), Bill C-62 (i) replaces the common law duties of care and loyalty with statutory duties of care and loyalty parallel to those under the CBCA and incorporates both statutory due diligence and good faith reliance defences; (ii) expands the rights of indemnification; (iii) permits unrestricted D&O liability insurance coverage; (iv) adopts the same statutory conflict of interest regime found in the CBCA; (v) allows directors to meet by conference call and transact business by written resolution; and

(vi) gives directors the power to pass by-laws, which take effect immediately, do not require governmental approval and remain in effect (unless the members fail to confirm the by-laws at the next ensuing meeting of members);

- (b) For members, Bill C-62 (i) permits membership interests to be transferable if the articles or by-laws so provide; (ii) allows members to bring an oppression action, seek a compliance or restraining order and seek leave to bring a derivative action on behalf of the corporation; and (iii) grants members the power to set the number of directors and remove directors before the expiration of their terms of office by ordinary resolution;

- (c) Founders (incorporators) of corporations benefit from incorporation as of right rather than by the current letters patent system, which makes incorporation an exercise in Crown prerogative; and
- (d) Corporations enjoy all of the rights, powers and privileges of a natural person, thereby abolishing the ultra vires doctrine and enabling NFP corporations to engage in any commercial or non-commercial activities, subject only to voluntary restrictions contained in their articles (which will be needed if the corporation is to be or remain a registered charity under the Tax Act).

## 6. Remaining Issues

By any measure, Bill C-62 heralds a significant advance in NFP corporate law at the federal level. If, like the CBCA, it becomes a model for the provinces and territories, it may in the years ahead lead to a revolution in NFP corporate law across the country. Bill C-62 merits the strong support of the entire NFP sector (federal and provincial).

Having said that, certain issues remain:

- (a) The introduction of Part 6 (Debt Obligations, Certificates, Registers and Transfers) is a retrograde step in light of the recent introduction of securities transfer legislation at the provincial level and the compelling need for the federal government to vacate the field. The federal government needs to exit the field of securities transfers, not extend its reach. The overlap of federal and provincial laws in this respect is deeply flawed. Provincial securities transfer legislation such as the **Securities Transfer Act, 2006** (Ontario) already provides a comprehensive set of rules governing federal corporations. Also, Part 6 of Bill C-62 leaves transferrable membership interests to provincial law, creating an awkward bifurcation in the two types of securities that may be issued by a federal NFP corporation.
- (b) The inclusion of Part 7 (Trust Indentures) is questionable. Debt obligations issued under a trust indenture that are part of a distribution to the public should arguably be left to provincial securities regulation (in any event until such time as there is a national securities regulator in Canada). It is a flawed

concept to regulate issuers of debt obligations based on their choice of jurisdiction statute. Securities regulation should be based on whether the securities are offered to investors within a jurisdiction. Stated otherwise, securities regulation should focus on protecting investors within the home jurisdiction from issuers regardless from whence they originate and should not seek to protect foreign investors from Canadian issuers. Bill C-62 repeats the flawed concept built into the CBCA. If a federal NFP issuer issues a prospectus under the **Securities Act** (Ontario), Part V of the **Business Corporations Act** (Ontario) (the "OBCA") applies. The Director under the federal NFP Act may exempt federal NFP corporations from Part 7 if comparable regimes such as Part V of the OBCA or the U.S. **Trust Indenture Act of 1939** applies (which does not leave much for new Part 7 to do except generate the occasional need to obtain exemption orders).

- (c) Not counting the transitional and consequential provisions in Bill C-62, more than 25% of the provisions in Bill C-62 could, therefore, be dropped. It is a long and not user-friendly statute. For example, many provisions in the Act are unintelligible without the regulations which complete the total picture, having the upside of enabling the Act to be kept more current but having the downside of being less easy to use.
- (d) There is no limitation of liability regime contemplated for D&O under Bill C-62 to mirror the liability shields recently introduced in Saskatchewan and Nova Scotia NFP legislation.
- (e) Directors of NFP corporations remain liable for unpaid employee wages, vacation pay and other employee-related debts, which arguably could be left to be provided for by the provinces and territories where the employees work. It might strike some as incongruous that, for example, an employee in Nova Scotia is able to sue a director of a federal NFP corporation for unpaid wages but is not able to sue a director of a Nova Scotia company or society for the same debts.
- (f) The duty of care of D&O is not stated to be owed exclusively to the corporation. Based on the Supreme

Court of Canada decision in **Peoples v. Wise**, it is owed to a wider group of stakeholders, including, shareholders, creditors, employees, customers, government and the environment. While this is consistent with the CBCA duty of care, as of August 1, 2007, it is no longer consistent with the duty of care owed by D&O of an OBCA corporation, which, like the duty of loyalty, is owed exclusively to the corporation itself.

## 7. Conclusion

However, these are quibbles in light of the significant overall advance in the law that enactment of Bill C-62 promises. Arguably, the NFP sector will be much better off endorsing Bill C-62 as it is, rather than seeing it derailed for another three years, as was the fate of Bill C-21. If necessary, changes to Bill C-62 can always be made subsequent to its enactment. Meanwhile, perfection should not be allowed to become the enemy of improvement of this magnitude.

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Our Corporate Group provides practical advice to a wide range of businesses. We assist clients in setting up a corporate structure that will enable them to implement their business objectives securely and with minimum liability. We draft agreements to ensure that our clients' relationships with key parties, such as suppliers, distributors, customers and licensees are clear and enforceable. We also ensure that our clients' important business assets, such as intellectual property, are protected through appropriate agreements with employees, contractors and licensees. Our Corporate Group delivers comprehensive and fully integrated business law services including ongoing corporate and commercial advice to a wide variety of clients (for profit, NFP and governmental).

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The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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