THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

July 30, 2021

Via email: ic.nfpactreview-examenloibnl.ic@canada.ca.

The Honourable François-Philippe Champagne, P.C, M.P.
Minister, Innovation, Science and Industry
Innovation, Science and Economic Development Canada
235 Queen Street
Ottawa, ON K1A 0H5

Dear Minister Champagne,

Re: 2021 NFP Act Statutory Review Consultation Paper

The Canadian Bar Association's Charities and Not-for-Profit Law Section (CBA Section) is pleased to comment on the 2021 *NFP Act* Statutory Review Consultation Paper further to our meeting with representatives of Innovation, Science and Economic Development Canada (ISED) on July 6, 2021. This letter supplements our previous linked submission on the *Canada Not-for-profit Corporations Act* (NFP Act)[1] (2019 submission).

We would like to thank ISED for the full and candid discussion which allowed us to better understand the consultation's underlying issues. This letter follows up on important issues raised during our meeting.

The CBA is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. We promote the rule of law, access to justice, effective law reform and provide expertise on how the law touches the lives of Canadians every day. The members of the CBA Section practice in all areas of charities and not-for-profit law and in every size of practice.

Voting Rights of Non-Voting Members

In our 2019 submission, we stated that voting rights for non-voting members (including rights to vote as a separate class of members on issues of fundamental change) was inappropriate and problematic for the charities sector.

1 S.C. 2009, c. C-23.

In 2020, the *Not-for-profit Corporations Act, 2010* (Ontario) (ONCA)[2] was amended to remove any voting rights for non-voting members and mandatory separate class voting rights for voting classes of members. Corporations wishing to give their non-voting members a right to vote in certain circumstances, or to give voting members a separate class vote, may still do so in their articles or by-laws. The NFP Act thus remains the only non-share statute in Canada in which voting rights for non-voting members are mandatory and not subject to removal.

Non-voting and class voting rights changed the original governance structure of many charitable organizations when the governing statute changed from the *Canada Corporations Act* (CCA)[3] to the NFP Act, leading to serious problems and various "workarounds". The workaround for former non-voting members of pre- NFP Act corporations has been to remove these members from the corporation membership and re-designate them as "associates", "friends", "partners", "affiliates" and several other alternatives. This led to a perceived decline in engagement, as individuals prefer to identify themselves as "members" of organizations they support.

Nevertheless, because there is a lack of jurisprudence on this issue, it is uncertain whether a court would still treat them as "members" because of the attributes, rights and benefits attached to their affiliation. For example, would the court consider them to be a "group", as this term has not yet been judicially considered? In addition, the removal of membership status has meant that corporations receiving funding from these non members were deemed soliciting corporations when they would not have otherwise been so deemed.

Corporations established to offer services to members may find themselves in jeopardy of losing their non-profit status if the same services are provided to people who would otherwise have been members but are no longer described as such. For example, one of the criteria assessed by the Canada Revenue Agency on an entity's non-profit organization tax status under paragraph 149(1)(l) of the *Income Tax Act* (ITA) is whether the organization restricts its goods or services (such as sporting activities, dining and hall rental facilities, etc.) to members and their guests.

Giving non-voting members the right to vote imposes a greater record-keeping burden on corporations, including the requirement to keep and protect more personal information. In addition, the statutory default provision for a majority quorum may result in an inability to hold meetings at times of fundamental change, since most by-laws do not fix a quorum for non-voting members. It is generally understood in corporate law that, where classes vote separately, each class would need its own quorum to validly constitute a meeting.

For funding purposes, many organizations' service recipients must be members. Others, such as sports organizations, must require that their participants be members for insurance purposes. Corporations that are nevertheless forced to move members into non-membership categories because of NFP Act rules, potentially create a trip mechanism for insurance coverage because these activities are now those of third parties, rather than corporate members. As well, it is often inappropriate for these individuals to be given voting rights as, for example, they may be minors or dependent clients.

An organization with any kind of multiple membership classes cannot establish a delegate voting system. Organizations that tried to transition from the CCA had to engage in complex workarounds, including eliminating non-voting classes and merging voting classes into one, with complex methods of recognizing different interests in the corporation. In the absence of jurisprudence, particularly on the meaning of "class or group", we do not know if these workarounds will continue to be effective.

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2 S.O.2010, c.15

3 R.S C, 1970, c. C-32

By removing mandatory separate class voting rights and eliminating voting rights of non-voting members in all circumstances (which is presently the case under the British Columbia, Saskatchewan and Yukon acts[4] and will be under the ONCA), it will be possible to establish delegate voting systems in by-laws. As mentioned in our discussion, we are amenable to amendments to the NFP Act to make specific provisions (directly or in the regulations), governing the terms and conditions of a delegate system.

The administrative burden to organizations developing workarounds to deal with the issue of non-voting members voting in certain circumstances is significant. It can take hours of discussion with a client to determine the most reasonable workaround for a particular situation. It adds unnecessary complexity to an organization's governance structure. It creates an opportunity for organizations to misunderstand or misapprehend how they must operate. It can lead to an organization's inadvertent non-compliance with important meeting rules and procedures, which, in turn, can invalidate a members' meeting. It is inherently unfair that organizations able to afford legal counsel can use workarounds and organizations that do not have the necessary resources cannot. There should be a level playing field for all organizations.

Members are a fundamental to an organization. One of their most important roles is to elect directors. If there is uncertainty around elections, or if meeting rules are not properly followed, the election of directors can be disputed, and the entire governance of the organization questioned.

There is no caselaw in this area yet. The CBA Section is concerned that with the overly complicated and costly structures required to address this issue, some organizations may see their structures come under attack.

The not-for-profit sector wants to comply with the NFP Act. Unfortunately, in our view, parts of the Act make it very difficult for organizations to do so. The need for "workarounds" for so many different parts of the Act to allow organizations to continue to operate in the manner they were originally set up for is in itself a serious concern and causes organizations to look for alternative statutory regimes that provide more flexibility.

Recommendations:

1. Amend the NFP Act to remove the rights of non-voting members to vote in any circumstances.
2. Amend the NFP Act to remove the rights of separate classes of voting members to have a separate class vote on matters of fundamental change (making the separate class vote default is not preferred, as it would privilege organizations able to afford legal advice over those that cannot).
3. Amend the NFP Act to remove the words "or groups" or clarify that the two words "class" and "group" have the same meaning and are not to have different attributes.

Distribution of Property to Members

In our July 6, 2021, meeting, we raised concerns with the current iteration of the distribution of property to members under the NFP Act. You also asked us to consider situations where Indigenous organizations may make distributions to their members. We address these questions in turn.

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4 *British Columbia Societies Act*, SBC 2015, c.18, *Non-profit Corporations Act*, 1995, N-4.2, *Business Corporations Act,* RSY 2002, c. 20.

A. Lack of clarity around section 34 of the Act

Uncertainty in the Act: Section 34(1) of the Act is unclear. The Act expressly prohibits distribution of property or accretions to members "except in furtherance of its activities or as otherwise permitted by this Act". The wording "except in furtherance of its activities" is too vague to give meaningful guidance and clarification would be helpful. Specifically, provisions expressly permitting corporations to return equity interests to its members - which often applies to social clubs, such as golf clubs - would be of great assistance.

Confusion with non-profit status under the ITA: In addition to corporate uncertainty, permitting distribution to members in some circumstances could result in a not-for-profit corporation making a distribution that could compromise its status as a charity or a non-profit organization under the ITA. The ITA stipulates that the income of a charity or non-profit organization must not be available for a member's personal benefit. Allowing distributions to members under the Act "in furtherance of its activities or as otherwise permitted by this Act" creates confusion, since organizations may not realize that a not-for-profit corporation must adhere to both statutes, even where the CNCA is more permissive than the ITA.

Types of CNCA corporations: The CBA Section appreciates that, along with public benefit and member benefit corporations, the Act may also apply to corporations structured to make distributions to their members. In our experience as advisors to the not-for-profit sector, such corporations are extremely rare, and we believe that this rarity supports the need for further clarification of the distribution rules under the Act.

B. Unintended consequences of section 235 of the Act on members' rights

This second issue is related to the issue of uncertainty in the Act and deals with the unintended consequences of requiring soliciting corporations (and others referred to in paragraph 235(1)(c) of the Act) to include in their articles that any property remaining on liquidation after the discharge of any liabilities of the corporation, be distributed to one or more qualified donees.

We have several concerns. First, this requirement can lead to the unintended non-compliance of a corporation that accidentally becomes a soliciting corporation (or a corporation described in paragraph 235(1)(c) of the Act) by virtue of additional donations. For example, COVID-related federal support for not-for-profit corporations led to many non-soliciting corporations becoming soliciting corporations (or subject to paragraph 235(1)(c)), when they never intended to achieve that status, and therefore did not include that provision in their articles. For corporations who intend to return to a non-soliciting status and not otherwise be subject to paragraph 235(1)(c), it would mean changing their articles to comply with section 235, and then changing them back once they are no longer a soliciting corporation. This is an undue administrative burden.

Additionally, having to change the corporation's articles to comply with section 235 of the Act could be a violation of a corporation's own articles or by-laws. For example, if a social club or other member benefit club that included provisions for a distribution to its members inadvertently became a soliciting corporation or otherwise caught by paragraph 235(1)(c), it would be required to choose between non-compliance with section 235 or amending its articles to remove the members' rights to their equity stake in the assets of the corporation.

C. Indigenous organizations

You asked us to consider whether the NFP Act's proposed amendments should allow for Indigenous organizations that make distributions to their members. We consulted lawyers with expertise in the structuring of community economic development activities of Indigenous communities and bands. We learned that Indigenous communities only use NFP Act corporations to accept government funding and then flow that funding to the community in various ways. These corporations do not make distributions to their corporate members.

The structuring of community economic development activities of Indigenous groups is complex and typically involves many different types of entities that are part of a large family of organizations. It is our understanding that these structures do not include NFP Act corporations; rather, they include share-capital corporations, unincorporated associations, and trusts.

There are some "independent" Indigenous organizations (i.e., not part of a community economic development structure to receive government funding) incorporated under the Act. However, we are not aware of any reason why these corporations might require special rules, regulations, or wording in the Act to account for them making distributions to their members.

The CBA Section believes that Indigenous organizations incorporated under the Act will benefit in the same manner as all other organizations from amendments that make the Act more practical, flexible, and easy to comply with. We do not believe that Indigenous organizations incorporated under the Act are making distributions to their corporate members.

We reiterate Recommendation no. 10 of the 2019 Submission:

> The CBA Section recommends that the phrase "or as otherwise permitted by this Act" at the end of section 34(1) be amended to clarify that it will apply to distributions made on dissolution, e.g., pursuant to the operation of section 220(3)(b) of the Act.
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> Also, the Act should be amended to expressly permit social clubs and other organizations to distribute surplus funds or property to their members outside the application of Part 14 in the case of resignation or termination of membership, and consideration be given to an exception specific to social clubs, defined similar to the "member-funded" societies under the British Columbia Societies Act, to enable distributions of property in accordance with the by-laws.

Electronic Voting Issues

The Act permits members to exercise their right to vote – on any matter, whether governed by the Act or not – in two ways: (i) at a meeting (in person or, unless prohibited by the corporation's by-laws, by a communication facility) or (ii) prior to a meeting by means of any absentee voting method permitted by the Act and the corporation's by-laws (i.e. proxy, mailed-in ballot, or telephonic, electronic, or other communication facility).

The fundamental purpose of member meetings is to offer an opportunity for members (not otherwise engaged in the governance or operations of the corporation) to interact with each other, directors, employees and other stakeholders, to receive information, and to exercise their limited right to vote.

Unfortunately, attendance at member meetings is often quite low. This lack of member participation may be attributed to several factors, including the difficulty of scheduling a meeting convenient for many individuals located across multiple time-zones and a lack of interest to attend a meeting only to vote on a very short list of legislatively mandated governance-related matters.

To encourage members to attend meetings, many organizations schedule their annual members' meetings in conjunction with a social event or conference. However, given the Act's constraints on the timing of annual meetings, this is often problematic for organizations that prefer the flexibility to hold their annual event at a different time or location but have limited options to maximize? ensure attendance at their meetings. Other organizations invite their members to discuss various operational and governance matters, in addition to those mandated by the Act, but by doing so risk blurring the line between seeking member approval versus member input. Some organizations, as an incentive, pay the members' travel costs and lodging to attend a meeting. Others opt for meeting by telephonic or electronic means; however, such means are often costly, complicated, administratively challenging, and inefficient when many attendees are involved.

While the NFP Act offers certain methods of absentee voting (i.e., ability of a member to vote by proxy, mailed-in ballot, or through an electronic, telephonic, or other communication facility prior to a meeting in lieu of attending the meeting) to increase the potential number of votes cast, many organizations are reluctant to permit absentee voting. For example, the use of proxies is often not desirable because: (i) proxyholders do not need to be members and therefore may have even less interest in or knowledge of the organization than the members themselves; (ii) the requirements for creating, sending, collecting, and verifying proxies are confusing, daunting, and time-consuming to both the organizations and their members, and thus a deterrent to their use; and (iii) many organizations fear that proxies will be abused and result in skewed votes.

The proxy requirements under the Act can also result in an extremely lengthy document with different requirements for the different votes (e.g., elections of directors when elections are held for different named positions and there are multiple candidates for each position). The requirement to use a complicated proxy form does not encourage member engagement. Even if voting by proxy is offered to members, the proxy must still be filled out by a member and the proxyholder must still attend the meeting; neither can be forced to fulfill either task.

The other methods of absentee voting available under the Act (i.e., voting by mailed-in ballot or by a telephonic, electronic, or other communication facility) are often expensive, time-consuming and complicated. They are not attractive for many organizations. For example, as noted our 2019 submission, the requirement that an organization have a system that counts votes which can be verified without the organization being able to identify how specific members voted typically requires an organization to use third party providers, which is even more complicated if proxies are permitted.

As a result, it is commonplace for quorum of a members' meeting to be set very low to ensure the meeting can be held. In practice, the need for member engagement at *formal* meetings has been significantly reduced in the sector. However, as they still want to *informally* engage members, many organizations hold informational sessions prior to a meeting, with a formal vote based on the discussions held there to occur at a later meeting (and most often attended by a lot less members). Other organizations gather members' votes by various means prior to a meeting and then have the members confirm or ratify the results of the votes at a formal meeting. In other words, to comply with the Act but still engage members, the sector has adapted by creating informal, non-binding, unregulated fora that offer members an opportunity to be indirectly involved in the decision-making process *outside* of meetings.

Permitting an organization to hold stand-alone member votes outside the confines of a meeting would give legal, binding effect to the informal decisions already made by members. Moreover, regulating such votes would ensure informed voting and equitable access. Recognizing that a stand-alone vote option may not be necessary or appropriate for all organizations, we propose that stand-alone member votes be optional (i.e., can be prohibited by the by-laws). Even if permitted, stand-alone votes should only be called by a corporation's board of directors since it has the responsibility to ensure that meeting-related funds are spent appropriately. We further recommend that the Act's regulations set out requirements relating to:

- notice period of a vote (i.e., long enough to permit members to properly requisition a special members' meeting in lieu of the stand-alone vote);
- ability of members to submit written statements, of a prescribed length, in support of or in opposition to the vote;
- information that must be submitted with the notice of the vote;
- minimum length of voting period (i.e., over a certain number of days to optimize engagement); and

- method for members to ask and receive answers and further information from the board of directors during the voting period.

We reiterate Recommendation no. 16 of our 2019 Submission:

> The CBA Section recommends adding language to section 165 that clearly authorizes a corporation to conduct, at the board's discretion, a vote of members at any time, and not necessarily in connection with a meeting of members. For example, a new section might read:
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> > Unless the by-laws otherwise provide, the directors of a corporation may determine to conduct a vote of the voting members at any time, and that vote may be held, in accordance with the regulations, if any, by means of a mailed-in ballot or electronic voting.

The CBA Section hopes that its comments in this supplemental submission will be useful in preparing for Parliamentary review of the Act and would be pleased to elaborate further on any of the matters discussed.

Yours truly,

(original letter signed by Julie Terrien for Florence Carey)

Florence Carey
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