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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

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This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Alex Mesbur at 416.593.3949 or amesbur@blaney.com.

NEW RULES FOR NON-PROFIT CORPORATIONS PROMISE TO SUBJECT BOARDS TO GREATER SCRUTINY

Mona Taylor

The federal government is planning a new set of operating rules for non-profit corporations, such as business and professional associations, park-league hockey teams, member-owned ski, golf and sailing clubs, and other community enterprises, that are governed by the Canada Corporations Act (CCA).

If it becomes law, Bill C-21, the proposed new Canada Not-For-Profit Corporations Act, will replace Parts II and III of the CCA. The amendments being developed will be the first to be put into effect since 1917.

While Bill C-21creates more accountability by non-profit corporations and their directors, it provides more protection from liability. It creates flexibility by providing for more types of corporate actions and fundamental changes and makes the incorporation process more efficient. It also enhances the rights and protections of members of non-profit corporations.

While there are obvious advantages to broader members' rights and protections and the greater member participation that they encourage, there are potential consequences. What if a determined minority wants to take a non-profit's agenda in a direction that is not supported by the majority and the board? Presumably, the majority will prevail, eventually, but at what financial, emotional and organizational cost?

One implication is that non-profits that have been relatively casual about who they choose to admit to membership will start exercising a new vigilance to satisfy themselves that new members have perspectives and interests compatible with the organization's history, membership and values.

The proposed legislation would replace the "letters Patent" system of incorporation, which requires an extensive and labour-intensive prior review by federal officials, with an "as of right" system, where the applicant walks up to the counter, files articles, pays a fee and is granted incorporation on the spot. It would also give organizations much broader discretion to adopt by-laws to fit their particular needs.

In respect of greater participation by members, the new law would allow them to monitor the board's performance more closely and to protect their rights. Specifically, it would give

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them greater access to corporate records and membership lists. To guard against the misuse of any information they consequently gleaned, members would be required to provide statutory declarations as to how they intended to use corporate information before they were given access to it. The proposed legislation would also equip members with mechanisms to enforce their rights.

With regard to financial accountability, the legislation would require all non-profits to produce annual statements. The type of financial review required for each corporation would depend on its size and whether it was a soliciting organization a term which will be defined in the legislation.

The new legislation would also be explicit about the duties of directors and the behaviours required of them. The present law does not set out such a standard of care, nor does it provide any grounds for directors to defend themselves against legal action.

The proposed legislation establishes a standard of care that clarifies the nature of a director's responsibilities. It requires directors to act honestly and in good faith with a view to the best interests of the corporation – to exercise the care, diligence and skill of a reasonably prudent person and to comply with the legislation and the corporation's Articles and by-laws. It also provides them with a due diligence defence, which makes any challenged actions they take fully defensible if they can establish that those actions were reasonable.

The proposed legislation clears the way, as well, for members to seek and win court order investigations of alleged corporate misdoings, and it enables the Court to issue an order to require compliance with the legislation, regulations, articles and/or by-laws. In addition, it makes derivative actions and oppression remedies available to members and other complainants who feel aggrieved by the corporation.

In order to protect religious organizations from member attacks on religious tenets, a faith based defence will be introduced. An organization will be able to assert a faith based defence if the disputed action or decision (to deny marriage rites to a same-sex couple, for example) is based on a tenet of faith and it is reasonable to base the decision on a tenet of faith.

Once the revised statute and regulations are debated, passed and put into force, all non-profits now incorporated federally will be given three years to bring their organizations into compliance with the new legislation. Each will receive a notice that the new legislation is in force and that the transition must be completed. Transition will normally require a review of a corporation's operating by-laws and the filing of Articles of Continuation. While a transition will have to be approved by the members of an organization, amended by-laws will not have to be approved or submitted to Corporations Canada.

The new law will require corporations to submit Articles of Continuance to Corporations Canada, but there will be no fee for applying

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for a Certificate of Continuance during the transition period. Once Articles of Continuance are approved, a Certificate of Continuance will be issued.

Until an organization is issued a Certificate of Continuance, it will be governed by the old legislation and will not be able to benefit from the new legislation. If a corporation fails to complete the transition within the required three years, it will be open to dissolution and the loss of its advantageous tax status. ■

The new legislation may be passed by this fall. We will keep our readers advised.

RECENT CHANGES TO U.S. BANKRUPTCY LAW MAY LIMIT NUISANCE CLAIMS AGAINST CANADIAN SUPPLIERS

Deborah S. Grieve & Domenico Magisano

As insolvency counsel, part of our practice involves helping Canadian suppliers with their issues with American customers who become insolvent.

One frustrating and irritating surprise for such clients is when they receive notice that they are being sued in the United States as part of the U.S. customer's insolvency proceedings. The typical claim against such clients is for repayment of the amount (often small) that the U.S. customer paid for goods and services, in what the client thought was the ordinary course of the customer's business.

A client finding itself in such a situation generally does not understand why it is being sued, as its only connection with the U.S. company is that it has supplied goods and services for which it has been paid. The basis for the lawsuit is the allegation that the U.S. customer should have paid higher-ranking creditors first, and not the Canadian supplier, who is therefore alleged to have received preferred treatment, with "preferential payment."

As it is unwise for clients simply to ignore litigation against them in the United States, the process of reviewing contracts and receipts, assessing the claim and drafting a response, must begin, all in an effort to have the preference action, which is often simply a major nuisance for the client, dismissed. The supplier may well have a strong defence, but still faces incurring the time and expense of defending the action, and the U.S. company and its administrators will rarely dismiss the action without some payment. They understand that the cost of defending U.S. litigation can easily exceed the amount of the claim itself. Often the client's business decision is to pay thousands of dollars, even if it should otherwise have no liability, just to make the problem go away.

Unfortunately, attacking what appear to be ordinary business transactions in ensuing bankruptcy proceedings had become fairly commonplace practice in the U.S.. However, in an effort to remedy the situation, the United States government recently amended its bankruptcy legislation. One of the amendments is aimed at reducing these claims and limiting the burden of preference litigation on suppliers.

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Under the United States Bankruptcy Code, a trustee may attack any transfer of interest (which includes payments) by a debtor within 90 days of its filing for bankruptcy protection. The provisions are arguably broad enough to catch most suppliers of the debtor, merely because they were paid for services rendered within 90 days of the U.S. company's filing for bankruptcy protection. Once the net was cast and the lawsuit served, the party sued then had to prove why it should be entitled to keep the payment it rightfully earned. Prior to the most recent amendments, the defendant in a preference action had to demonstrate that the payment received had been made in the ordinary course of business according to industry standard *and* in accordance with the parties' historical dealings.

While demonstrating that payment has been made in accordance with the parties' historical dealings is fairly straight forward, proving the "ordinary course of business" in a particular industry can be much more problematic. What constitutes "ordinary course" in a given industry can be difficult to define, and may require expert evidence As a result, preference litigation can be surprisingly complex and the process, accordingly, can be quite expensive. So, historically, the threat of having to prove an "ordinary course" transaction has had Canadian suppliers trying to settle as soon as possible.

Under the new amendments, suppliers can still be sued, and if sued must still demonstrate why they are entitled to the challenged payments. However, now the test for proving the entitlement to payment is less stringent. With the change in the legislation, if a defendant can prove that the payments in question were made in the ordinary course of its own dealings with its customer, that will be sufficient to defend the preference action. It will eliminate the need to involve and define "ordinary business terms" for the given industry as a whole.

The amendments to the U.S. Bankruptcy Code also restrict most preference actions to claims of over $5,000. This will limit claims for small dollar amounts. From a supplier perspective, the claims under $5,000 are the most frustrating because whether the supplier defends or settles, it will still be paying the equivalent of a large portion of the claim, whether to the claimant or as a result of the costs involved in the process.

In short, the recent amendments to the U.S. Bankruptcy Code will allow trustees to proceed with legitimate preference claims, while limiting their ability to pursue what our clients have found to be nuisance claims. Hopefully, these amendments will have the desired effect. ■

Blaneys on Business is a publication of the Business Law Department of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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