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INVESTMENT BY NONPROFIT ENTITIES

Feasibility Study

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ALBERTA LAW REFORM INSTITUTE

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This type of publication is one of the first of its kind–where we explain the reasons and background, in this case, for not proceeding further with a formal project. Getting to this stage involves a significant amount of legal research as well as a pragmatic consideration of our project selection criteria.

Margaret Shone is the counsel to whom the responsibility for carrying out this task has fallen. Parts I and II illustrate the comprehensiveness and depth of study which is inherent in a Feasibility Study. Part III describes the reasoning of the Board in reaching a decision.

We acknowledge with gratitude the work of Ms. Shone in carrying out the background research and guiding the Board to its ultimate decision.

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Investment by Nonprofit Entities

PART I – Introduction

A. Project Request

[1] We published Final Report No. 80 on *Trustee Investment Powers* in February 2000. In our report, we recommended that Alberta adopt the "prudent investor" approach to the scope of a trustee's investment powers where the trust instrument does not define them.[1] This approach would replace the "legal list" approach taken in the *Trustee Act*[2] which had become outmoded. The *Trustee Act* has now been amended in accordance with our recommendations.[3]

[2] Report No. 80 does not include consideration of the question whether nonprofit entities should be held to the trustee investor standard.[4] Nor is there any direct

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[1] The powers and duties of a trustee may be imposed by statute, by the express trust terms that accompany the transfer of property, or by the courts where the circumstances of the transfer imply the existence of a trust. Under ALRI's recommendations, the prudent investor rule would become the default rule for all trusts that do not expressly stipulate the trustee's investment powers.

[2] Formerly R.S.A. 1980, c. T-10, s. 5; now R.S.A. 2000, c. T-8, s. 5.

[3] *Trustee Amendment Act 2001*, S.A. 2001, c. 28, 2001, proclaimed into force February 1, 2001. Section 9(1) of the amending legislation (the transitional provision) preserves the "legal list" approach for trust instruments in existence when the amendment takes effect where the trust instrument defines trustee investment powers by express reference to the *Trustee Act*. It does so by reproducing the repealed sections in a Schedule to the Act and making them apply.

[4] Appendix B of Final Report No. 80 lists 14 statutes and 3 regulations that incorporate the *Trustee Act*'s investment provisions by reference. Section 9(4) of the *Trustee Amendment Act, 2001* preserves the "legal list" approach with respect to the provisions in this legislation, using the Schedule containing the repealed provisions and providing for consequential amendments to the legislation affected so that the Schedule (and not the amended Act) applies. We have not examined the function that is governed by the trustee investor standard being performed under each of these Acts in order to determine the underlying principles being applied in making the determination that the *Trustee Act* standard should be incorporated by reference in these pieces of legislation. Nor have we examined the case law to determine whether the legislation imposes the trustee obligations on the corporation or on the directors and officers in their personal capacity. The current legislation is:
Statutes – *Agricultural Societies Act*, R.S.A. 2000, c. A-11, s. 29(3); *Cemeteries Act*, R.S.A. 2000, c. C-3, ss 36(1), 45(4); *Condominium Property Act*, R.S.A. 2000, c. C-22, s. 43; *Dependent Adults Act*, R.S.A. 2000, c. D-11, s. 39; *Funeral Services Act*, R.S.A. 2000, c. F-29, s. 8(3); *Historical Resources Act*, R.S.A. 2000, c. H-8, s. 41; *Livestock and Livestock Products Act*, R.S.A. 2000, c. L-18, s. 30(2); *Opticians Act*, R.S.A. 2000, c. O-9, s. 3(2); *Podiatry Act*, R.S.A. 2000, c. P-16, s. 3(2); *Public Trustee Act*, R.S.A. 2000, c. P-44, s. 28(5); *Real*
(continued...)

consideration in the report of the investment standard applicable to nonprofit companies and societies.[5]

[3] A lawyer who served on our project committee asked us to consider recommending the adoption of the prudent investment standard not only as the default position for all trustees, but also as the default position for the directors and officers of nonprofit companies and societies. He reasoned as follows:

(1) the law with respect to the investment powers of societies and nonprofit companies is uncertain and should be clarified;

(2) corporate directors and officers are, for all intents and purposes in the position of trustees with respect to the use of donated funds;

(3) the prudent investor rule already applies to some (comparable) organizations established by special acts (e.g. *Credit Union Act*, *Glenbow-Alberta Institute Act*, *Regional Health Authorities* Act, *Calgary Foundation Act*);

(4) some provinces specify the investment standard that applies to nonprofit companies and societies by employing one or another of various strategies:

- investment in accordance with the constating document or, if no provision is made, then according to the trustee standard (British Columbia, Manitoba Law Reform Commission)
- investment by charitable corporations according to the trustee standard, by membership corporations as the directors think fit (Saskatchewan)
- investment by entities incorporated for a religious, educational, charitable or public purpose in accordance with the trustee standard (Ontario, by implication from judicial application of the *Charitable Accounting Act*);

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[4] (...continued)
Estate Act, R.S.A. 2000, c. R-5, s. 58(1); *Safety Codes Act*, R.S.A. 2000, c. S-1, s. 21(3); *School Act*, R.S.A. 2000, c. S-3, s. 60(2). The *Irrigation Districts Act*, R.S.A. 2000, c. I-11, replaced the Irrigation Act in 1999. The new Act does not refer to the *Trustee Act.*
Regulations – *Automotive Business Regulation,* Alta. Reg. 192/99, s. 26; *LIS Delegated Authority Regulation*, Alta. Reg. 219/98, s. 11(4); and *LIS Delegated Authority Regulation*, Alta. Reg. 221/98, s. 11(4).

[5] Neither the *Societies Act*, R.S.A. 2000, c. S-14, nor the *Companies Act*, Part 9, R.S.A. 2000, c. C-21, is among the legislation listed in Appendix B of Final Report No. 80. The recommendations in that Report deal with Acts that incorporate section 5 of the *Trustee Act* by reference, but they do not address Acts that are completely silent about the investment powers of persons who have fiduciary responsibilities under a statute.

(5) given the fiduciary relationship existing between a nonprofit company or society and its directors, in the absence of a contrary intention in the constating documents (that is, the documents establishing the legal form) of the entity, "the preferable approach is to adopt the prudent investor standard for all trustees and for the directors and officers" of Alberta nonprofit companies and societies.

B. Disposition of Project Request

[4] The issue whether nonprofit companies and societies should be subject to the prudent investor rule raises considerations that reach beyond the scope of Final Report No. 80. In our view, the separate considerations require the designation of a separate project which would include undertaking the considerable research necessary to fully investigate the issue and conducting a broad consultation with volunteers and staff in the nonprofit sector and with members of the public. For these and the other reasons that we identify in Part II of this memorandum, we have decided not undertake a project at this time.

C. Purpose of This Memorandum

[5] This research memorandum records the results of the preliminary research we conducted pursuant to the request to recommend the imposition of the prudent investor standard on nonprofit entities and to treat the directors and officers of nonprofit entities as trustees for this purpose. We present our findings for the benefit of persons who may wish to pursue the matter further.

D. ALRI Project Selection Process

[6] Before detailing the preliminary research that has led us to reserve our opinion about whether the approach suggested is the one that should be taken, we will describe our project selection process.

[7] In deciding whether or not to undertake a project, ALRI now follows a three-step process. The goals of this process are: to make informed decisions regarding what projects to take on; to clearly set out the scope, objectives and structure of a project once it has been approved; and to make provision for review and reassessment of the scope or

viability of the project as it unfolds. The three phases are: preliminary assessment; feasibility study and project.

> *Phase 1 -- Preliminary Assessment*. Initially, all topics suggested for projects are placed on a list and priorized for attention on the basis of a "preliminary assessment" briefly outlining the general scope and intent of a project.
>
> *Phase 2 -- Feasibility Study*. The topics that are given higher priority move into a second phase during which: the critical issues requiring examination in a project are investigated in greater detail in order to clearly define the scope of the proposed project; the level of interest shown by the legal community and other stakeholders is gauged; and all costs and related resources necessary to achieve project delivery are assessed. The Board then considers the information acquired during the feasibility study and decides whether or not to adopt the topic as a project.
>
> *Phase 3 -- Project*. This is the period during which full research and analysis are carried out culminating with the finished project.

[8] Criteria common to each phase guide the decision whether or not to proceed with a project. Those criteria are:[6]

- a clear law reform issue -- is there a problem that needs to be addressed?
- contribution to ALRI's goals and objectives, which include a number of component principles[7]
  - each project must meet a perceived community need by providing a remedy for a deficiency in the law or in the administration of justice.
  - a project must be one that neither the political process nor the administrative process is likely to deal with effectively.
  - each project must be one that falls within the capability of the Institute, as a group of lawyers acting with the best available advice from segments of the public and from law and other disciplines.
  - the total program must make contributions both to technical areas of law and to areas of law involving social policy.

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[6] ALRI, *Project Management Guide* (December 2001 draft), at 5, 6 and 10.

[7] ALRI, *Annual Report, July 2000 to June 2001*, at 7.

- the demands placed on ALRI’s human, financial and operational resources
  - would the benefit of the proposed solution be commensurate with the effort which would have to go into the project?
  - is the complexity of the area such that it would be difficult to manage the project?

- contribution to a broader based research project;

- potential of influencing or impacting the law reform process – the solution should have a reasonable chance of being adopted;

- delivery within an available ‘window of opportunity’ where timeliness affects the chance of adoption; and

- adding informative value to the public debate on a matter of law.

We return to these criteria and consider their application to this topic suggestion in Part III of this memorandum.

PART II – Research Memorandum

A. Framing the Issue

[9] The suggestion made to us was that the prudent investor rule recommended for trustees in ALRI Report No. 80 on *Trustee Investment Powers* (and now enacted), should apply to the investment of funds held by nonprofit entities and that, with respect to investment, the directors and officers of such entities should be treated as trustees of the funds.

[10] This suggestion proposes a solution to a perceived risk. We think it desirable to step back from the proposed solution in order to consider the following questions, to which we see no ready answers:

(1) *Need for an investment standard?* – Is there a need to impose an investment standard on nonprofit entities? What is the problem that needs to be cured? Is additional regulation required?

(2) *Policy objective served?* – What policy objective or objectives would be served by imposing an investment standard on nonprofit entities?

(3) *What investment standard?* – What should the investment standard be? What options exist? Should the investment standard apply universally or only in default of another direction (e.g. a standard set by the nonprofit entity in its constating documents or defined by a trust settlor)? Should nonprofit entities be under, or protected from, a duty to invest?

(4) *Imposed on what entities?* – Should the investment standard be imposed on all nonprofit entities, or only some of them? If only some, which ones and in what circumstances?

(5) *Governing the investment of what funds?* – Should the same standard apply to all funds managed by the nonprofit entity or should distinctions be made for funds having different sources?

(6) *Sanctions for failure to meet the standard?* – What sanctions should be imposed for failure to meet the investment standard?

(7) *Enforceable against whom?* – Should the sanctions target the nonprofit entity or the directors and officers in their personal capacity? What are the implications of piercing the corporate veil?

B. The Context of Reform

[11] Preliminary research suggests that the solution to the issue whether or not to impose an investment standard on nonprofit entities is not straight forward. In fact, the issue is one small piece in a complex puzzle intermingling issues of corporate, trust, contract, tax and charity law – each being an area of legal specialization full of its own complexities.

1. Nonprofit sector a "third order" of organization

[12] In its 1996 report on the *Law of Charities*, the Ontario Law Reform Commission refers to the nonprofit (or "charity") sector as a "third order" of organization in society, existing "on a par, theoretically, with the private or market sector and with the public or government sector":[8]

> Like these, it is implicated in the allocation of resources, the distribution and redistribution of wealth, and the control of economic and social power. Also, like these it is, in principle, founded on a very distinctive logic of human relations: its culture of altruism stands in contrast to the market sector's culture of contract and the public sector's culture of law and the public interest.

[13] The nonprofit sector, run largely by volunteers, is relatively efficient. The "delivery of government-funded social and cultural services through the instrumentality of

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[8] Ontario Law Reform Commission, *Report on the Law of Charities* (1996, 2 vols.) (hereinafter OLRC 1996 Report), at 3. The OLRC observes:

> Despite this position of theoretical pre-eminence, ... the charity sector in Canada has attracted comparatively little academic, political, or legislative interest. As a consequence, there is a noticeable lack of informed public debate on the role of the sector in Canadian society.

The Report continues (*ibid*., fn. 10):

> This is changing, however. The main current works on the law of charity are: D.J. Bourgeois, *The Law of Charitable and Nonprofit Organizations*, 2d ed. (Markham, Ont.: Butterworths, 1995); R.J. Burke-Robertson, *Non-share Capital Corporations* (Scarborough, Ont.: Carswell, 1992); Canadian Centre for Philanthropy, *Law, Tax and Charities: The Legislative and Regulatory Environment for Charitable Nonprofit Organizations* (Toronto: 1990); A.B.C. Drache, *The Charity and Not-for-profit Sourcebook* (Scarborough, Ont.: Carswell, 1995); A.B.C. Drache, *Canadian Taxation of Charities and Donations*, rev'd ed. (Don Mills, Ont.: Richard de Book, 1994); and D.W.M. Waters, *Law of Trusts in Canada*, 2d ed. (Toronto: Carswell, 1984) (hereinafter referred to as "Waters, *Law of Trusts*"). See, also, C.E.D. (Ont. (3d), Vol. 4, Title 24 "Charities," and Vol. 1A, Title 10 "Associations and Nonprofit Corporations;" C.E.D. (West 3d), Vol. 5, Title 24 "Charities," and Vol. 12, Title 10 "Associations." There have also been several publications resulting from continuing legal education seminars. These include M. Siegel, *Nonprofit Organizations and Charities for the 90's* (Toronto: Law Society of Upper Canada, Dept. of Continuing Legal Education, 1993); Canadian Bar Association, Continuing Legal Education, *Charities and the Tax Man and More* (Toronto: 1990); and Canadian Bar Association, Continuing Legal Education, The Charitable Mosaic (Toronto: 1983).

charitable and nonprofit organizations"[9] attests to this sector's usefulness. But, as the OLRC notes, its capacities are limited by its economic and human resources:[10]

> At the same time it is critical to recognize that the sector itself has a very limited capacity, in terms of both economic and human resources, to respond to a sophisticated regulatory regime.

Any recommendations for change should not discourage the good being done. As Innes emphasizes, volunteer directors should be able "to participate in charitable activities without courting the possibility of financial ruin."[11]

2. Role of federal and provincial governments

[14] Constitutionally, both the federal and provincial governments have strong roles to play in the regulation of the nonprofit sector:[12]

> Almost any conceivable regulation of the nonprofit or charitable sector could be justified as both valid federal and valid provincial legislation: federally, as legislation in relation to income tax; and, provincially, as legislation in relation to charity, the latter pursuant to section 92(7) of the *Constitution Act, 1867*, which establishes provincial legislative jurisdiction in respect of "the establishment, maintenance and management of hospitals, asylums, charities and eleemosynary institutions ...".

The federal government plays a dominant role by granting tax-exempt status to nonprofit and charitable organizations.[13] It also makes tax credits and tax deductions available to individuals and corporations for donations to charitable organizations.[14]

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[9] *Ibid.* at 4.

[10] *Ibid.* at 5.

[11] William I. Innes, "Liability of Directors and Officers of Charitable and Nonprofit Corporations" (1993), 13 Estates and Trusts Journal 1-27 & 151-175, at 175.

[12] OLRC 1996 Report, *supra* note 8, at 5.

[13] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), ss. 110, 118.1, 149 and 149.1, with amendments.

[14] The OLRC states, in its 1996 Report, *supra* note 8, at 2: "The federal government also plays a significant role in the sector through its incorporating power and, to a lesser degree, its spending power." Footnote 5 expands on this point:

> See *Canada Corporations Act*, R.S.C. 1970, c. C-32. There are over 3,000 federally incorporated nonprofit corporations. Many of these have been incorporated by special Acts. See, for example, *An Act to incorporate the Governing Council of the Salvation Army in Canada*, 1909, 8-9 Edw. 7, c. 132 (Can.), as am. by S.C. 1916, c. 63 and c. 64; S.C. 1957, c. 55; and S.C. 1962, c. 40. Other federal statutes of interest are listed *infra*, Appendix B-1 (public statutes) and Appendix B-2 (recent private Acts).

[15] Areas of provincial government involvement include: (1) the general nonprofit corporation law; (2) the law governing unincorporated associations; (3) the law governing charitable fundraising; (4) the provincial income and property law; (5) the laws governing the licensing of gambling events; and (6) the many laws establishing supervisory and discretionary granting powers in numerous government ministries and agencies.[15]

3. Relationship between law governing purpose trusts and law governing nonprofit entities

a. Purpose trusts

[16] Historically, "[t]he law of trusts was adapted to the purpose of charitable activity in order to give effect to the intentions of donors, usually testators, to advance the cause of charity."[16] Persons wishing to contribute financially to societally worthy causes did so through the vehicle of a "purpose trust." Such trusts could be "charitable" or "non-charitable." Gillese describes the "charitable trust" in this way:[17]

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[15] Compare OLRC 1996 Report, *ibid.* at 3.

[16] OLRC 1996 Report. *ibid.* at 388. Fn. 6 elaborates:

> Other legal systems have invented other ways of permitting individuals to endow wealth to a charitable or public purpose in perpetuity. The Greeks created perpetual endowments by gifts to a divinity, or a temple, or to a city by declaration in front of the popular assembly. Such gifts could be devoted to education, the support of athletes, the worship of a god or hero, or the construction and maintenance of public baths. Imperial Roman law permitted emperors to create charitable endowments for the relief of the poor by treating the endowments as a separate part to the *fiscus*. Roman citizens could do the same thing by gifts to permanent entities such as a *collegium* or *municipum*. The universal Christian church provided a vehicle for charitable sentiments and a model which inspire the founding of church-sponsored charitable institutions, such as orphanages, hostels for pilgrims, and hospitals. Contemporary civil law systems envisage a category of juristic person which has as its substratum charitably endowed assets, not shareholders or members. On these examples, see, generally, P.C. Hemphill, "The Civil-Law Foundation as a Model for the Reform of Charitable Trusts Law" (1990), 64 Australian L.J. 404; and R.-J. Dupuy, ed., *Le droit des fondations en France et à l'étranger* (Paris: La Documentation française, 1989). See, also, P.W. Duff, *Personality in Roman Private Law* (Cambridge: Cambridge University Press, 1938); M. Pomey, *Traité des Fondations d'utilité publique* (Paris: P.U.F., 1980). Now see the *Civil Code of Quebec*, arts. 1256-1259, for a modern version of the civil law foundation. See M. Boodman, *Les libéralités á des fins charitables au Québec et en France* (Montreal: Corporation Margo, 1980); J.E.C. Brierley, "Le régime juridique des fondations du Québec" in Dupuy, *supra*, at 81; J.E.C. Brierley, "The New Quebec Law of Trusts: The Adaptation of Common Law Thought to Civil Law Concepts" in H.P. Glenn (ed.) *Droit québecois et droit français: Communauté, Autonomie, Concordance* (Cowanvill, Que.: Yvon Blais Inc., 1993) at 383; and A.J. McClean, "The Trust in the Civil Code of Quebec in "Canadian Institute for Advanced Legal Studies, *Conférences sur le nouveau Code civil du Québec, Actes des Journées louisianaises de l'Institut canadien d'études juridiques supérieures* (Cowansville, Que.: Yvon Blais Inc., 1992).

[17] Eileen E. Gillese, The *Law of Trusts* (Irwin Law: Publications for Professionals, 1997), at 57. The

(continued...)

> Charitable trusts ... are trusts set up by individuals to accomplish public purposes that the courts have accepted as warranting certain advantages. A charitable trust does not benefit persons directly; instead, the public, or a segment of the public derives a benefit from the trust indirectly. A charitable trust is a purpose trust – one that has as its paramount obligation the fulfilment of a task that the creator of the trust wishes the trustee to perform through the use of the trust property.

[17] Advantages of establishing a charitable trust include: (1) extensive tax relief at the federal, provincial and municipal levels; (2) cy-près distribution if the stated objects of the trust are uncertain (ordinarily a trust fails where its objects are uncertain); (3) indefinite duration – the perpetuity rule against excessive (or perpetual) duration does not apply.[18]

[18] The primary disadvantage of a "charitable trust" is that, working from a list of the purposes contained in the Preamble of the *Elizabethan Statute of Charitable Uses, 1601*, the courts have given a restrictive interpretation to the purposes recognized as charitable.[19] The classic statement is found in the House of Lords decision in *Income Tax Special Purposes Commissioners v. Pemsel*:[20]

> "Charity" in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.

The first three divisions – relief of poverty, advancement of religion and advancement of education" – all have qualified meanings.[21] The case law on the fourth division – other

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17 (...continued)
description that follows in this section of the paper is based on Gillese's chapter 4.

18 *Ibid.* at 58-60.

19 A 'charitable trust" must satisfy fives tests: *ibid.* at 61-64. First, the purpose must come within one of the accepted categories identified in *Pemsel*. Second, the benefit must extend to a significant segment of the community. Third, the benefit must serve society. Fourth, the dominant purpose of the trust must be charitable. Fifth, the trust must be without political purpose.

20 [1891] A.C. 531 at 583 (H.L.).

21 Gillese, *supra* note 17, at 61.

purposes beneficial to the community – is all over the map (it is "not susceptible to any cohesive principle or set of principles"[22]).

[19] The law relating to non-charitable trusts (that is, trusts not recognized by the courts as charitable) is less clear. Non-charitable trusts have gone in and out of judicial fashion. The current trend may be towards validating them.[23] The so-called "beneficiary principle" or the "enforceability objection" poses the main obstacle to their acceptance as valid:[24]

> The primary objection to non-charitable purpose trusts was well put in *Morice v. Bishop of Durham*,[25] where it was categorically pronounced that the chancery courts would not enforce non-charitable purpose trusts because "There must be somebody, in whose favour the court can decree performance."[26] This is known as the "beneficiary principle," or the "enforceability objection." It is based on the fact that the essence of a trust is that a trustee is obliged to perform the trust. There can be no obligation on a trustee to perform unless there is a correlative right in someone else to enforce the obligation. And, since the beneficiary is a purpose and not an individual, there is no one who can bring an action to compel the trustee to perform.

[20] Unless the trust document defines investment powers, the trustee must comply with the trustee investment powers set out in the *Trustee Act*.[27]

b. Nonprofit entities

[21] In current times, the narrow scope of the purposes recognized as charitable and the inflexibility of the approach taken by the courts to the use of the purpose trust has led to

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[22] *Ibid.*

[23] See OLRC 1996 Report, *supra* note 8, at 436 for recommendations and reform in other jurisdictions. The OLRC opposes removing the exclusively charitable condition from purpose trusts in order to make the purposes trust available to all purposes: *ibid.*

[24] Gillese, *supra* note 17, at 56. "This objection does not apply to charitable trusts, since public officials are charged with the duty of enforcing such trusts."

[25] (1804), 9 Ves. Jun. 399, 32 E.R. 656, aff'd (1805), 10 Ves. Jun. 521, 32 E.R. 947 (Ch.) [*Morice* cited to Ves. Jun.].

[26] *Ibid.* (9 Ves. Jun.) at 405.

[27] *Trustee Act*, *supra* note 2, s. 2.

greater use of nonprofit entities by persons making donations for public purposes. Nonprofit entities may be incorporated or unincorporated. A corporation is a legal entity having the legal capacity of a natural person. An unincorporated association is not a legal entity; rather, it is a loose grouping of people who come together for a purpose.[28]

[22] Applying the general law, any one of three methods of incorporation may be adopted. The first method is the business corporation.[29] This is an inappropriate form because business corporations exist to make profits. The second and third methods are incorporation as a company[30] or a society.[31] Both of these methods are designed to serve charitable or social ends.[32] Incorporation may also be accomplished by public or private Act.[33] Incorporation limits the personal liability of members of a nonprofit entity in the same way that it limits the personal liability of members (shareholders) of a for-profit business corporation. This is a significant advantage.

[23] The law governing nonprofit entities embraces a broader concept of legitimate giving than the law governing the charitable trust. In Alberta, the *Companies Act* permits an association to register as a nonprofit company where it is formed "for the purpose of promoting art, science, religion, charity or any other useful object"[34] Another section permits an association formed "solely for the purpose of promoting recreation among its members" to do likewise.[35] The *Societies Act* permits nonprofit incorporation "for any benevolent, philanthropic, charitable, provident, scientific, artistic, literary, social,

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[28] Gillese, *supra* note 17, at 68. Different considerations govern the treatment of gifts to unincorporated nonprofit entities: *ibid.* at 68-70.

[29] *Business Corporations Act*, R.S.A. 2000, c. B-9.

[30] *Companies Act*, *supra* note 5.

[31] *Societies Act*, *supra* note 5.

[32] ALRI, Report No. 49 – *Proposals for a New Alberta Incorporated Associations Act* (March 1987), at 10-13.

[33] See e.g. *An Act to Incorporate the Synod of the Diocese of Edmonton and the Parishes of the Said Diocese*, S.A. 1914, c. 48 as am. S.A. 1953, c. 127 to permit a Consolidated Trust Account.

[34] *Companies Act*, *supra* note 5, s. 200(1).

[35] *Ibid.*, s. 202(1). The main difference between them is that the Registrar may impose conditions on an association registered under s. 200, but not under s. 202.

educational, agricultural, sporting or other useful purpose" unless an Act already provides for the incorporation of persons for that purpose.[36]

[24] Nonprofit (or "charitable") corporations enjoy tax and other benefits similar to those enjoyed by charitable purpose trusts.

[25] As already noted,[37] the *Societies Act* and the *Companies Act* are both silent as to the investment powers of entities incorporated under those statutes. Under corporate law, investment standards may be expressed in the incorporating ("constating", "formation") documents (by-laws in the case of societies, articles of association in the case of companies). If the constating documents are silent (as we believe is the usual situation), the corporate directors may decide on appropriate investment standards. That is to say, corporate (not trustee) rules and safeguards apply.[38] Appendix A provides an example of an investment policy adopted by a nonprofit entity in Alberta.

c. Causes of confusion

[26] Confusion surrounds the interplay between the law governing charitable trusts and the law governing nonprofit entities.

i. Similar purposes

[27] One source of confusion is that the charitable trust and the nonprofit corporation are both used by persons wishing to contribute funds to achieve worthwhile public purposes. This fosters a tendency to equate the functions performed and obligations carried out.

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[36] *Societies Act*, *supra* note 5, s. 3(1) and (2). Other legislation uses different definitions. For example, under the *Charitable Fund-raising Act*, R.S.A. 2000, C-9, s. 1(1)(c), a "charitable purpose" includes a philanthropic, benevolent, educational, health, humane, religious, cultural, artistic or recreational purpose, so long as the purpose is not part of a business. See also the federal *Income Tax Act*, *supra* note 13, s. 149.1. The *Canada Corporations Act*, R.S.C. 1970, c. C-32, s. 154(1), permits nonprofit incorporation "for the purpose of carrying on ... objects ... of a national, patriotic, religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character, or the like objects."

[37] *Supra* note 5.

[38] Certain statutes specify an investment standard, some by reference to the *Trustee Act*, *supra* note 2, others by requiring investment in accordance with prudent investment standards. These statutes are listed in ALRI Report No. 80 on *Trustee Investment Powers*, the latter at 24 (fn. 70) and the former at 109 (Appendix B). The statutes in Appendix B are listed *supra*, note 4.

ii. Property "settled" in trust on a corporation

[28] Both individuals and corporations are "persons" in law. Either may become a trustee. The fact that property (funds) may be transferred to a corporation in trust fans the tendency to equate the obligation of the corporation as a trustee of a charitable trust with the obligation of the directors who make decisions for the corporation. The issue is colourfully summarized in an Ontario judgment:[39]

> The position on the one hand is that the corporation is the trustee of its property, and that since the corporation is without body to be kicked or soul to be damned, its directors must be held to the duties and obligations of trustees. On the other hand is the argument that the corporation is a corporation duly regulated by statute and that, as long as the provisions of the statute are appropriately observed, the obligations of the directors have been met.

[29] "Piercing the corporate veil" in order to examine the role played by the directors and officers individually runs contrary to the concept of the corporation as "person" in law. Before recommending that the corporate veil be pierced, strong reasons weighed against corporate principle should be shown.

iii. "Fiduciary" obligations

[30] A third source of confusion derives from the fact that the duties owed by trustees to the trust beneficiaries and the duties owed by directors to the corporation are both "fiduciary" duties.[40] However, the requirements to which these fiduciary duties give rise are different. The duties of trustees are more onerous.

[31] Corporate directors and officers owe two duties to the corporation. The first is the duty to act honestly and in good faith. The second is the duty to exercise care, diligence and skill in carrying out their powers and discharging their duties. These duties, which were established at common law, have been enacted statutorily.[41]

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[39] *Re Public Trustee and Toronto Humane Society* (1987), 50 D.L.R. (4th) 111 (Ont. H.C.), at 121 .

[40] See also OLRC 1996 Report, *supra* note 8, at 456-460, discussing the use of the word "trust" by courts in the early days of corporate law.

[41] The *Business Corporations Act*, *supra* note 29, s. 122(1), enacts the common law duty owed by directors of a company:

> 122(1) Every director and officer of a corporation in exercising the director's or officer's powers and discharging the director's or officer's duties shall
>
> (a) act honestly and in good faith with a view to the best interests of the

(continued...)

[32] A number of recent decisions "have held that the charitable corporation is a trustee of its property for its purposes, or that its directors are trustees of its property for its purposes, or that the charitable purpose corporation is a 'trust by analogy'."[42] The OLRC explains the confusion as a product of the history of charities law and perceived deficiencies in the law governing nonprofit entities:[43]

> The principal cause of the confusion is the fact that the law of charity–both in its organizational and regulatory aspects–is equitable in origin and applied initially only to the charitable purpose trust, coupled with the fact that most modern charities are organized as corporations, and therefore are not, apparently, subject to this body of law. Thus, situations have arisen where due to deficiencies, apparent and real, in the legal regime governing

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[41] (...continued)
corporation, and
(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

[42] OLRC 1996 Report, *supra* note 8, at 456 and fn. 29, citing E.J. Mockler, *Charitable Corporation: A Bastard Legal Form* (1966) [unpublished]:

> As the common law has developed, numerous situations have arisen in which legal forms have been interbred; purity has been lost to expediency and the needs of the day have spawned some curious results. Forms, once strangers to each other, have been joined out of wedlock and the result has been the birth of a 'nullius filius.' Of all the bastard legal forms it is my contention that the charitable corporation ranks close to the top of the list. It has strains of both corporation law and trusts and on the paternal side one sees shades of the Chancellor's foot!

Fn. 29 continues:

> The main cases are the following: *Re Faith Haven Bible Training Centre* (1988), 29 E.T.R. 198 (Ont. Sur. Ct.); *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626, 26 E.T.R. 86 (Ont. Sur. Ct.); *Re Harold G. Fox Education Fund and Public Trustee* (1989), 69 O.R. (2d) 742, 34 E.T.R. 113 (H.C.J.); *Re Centenary Hospital Association and Public Trustee* (1989), 69 (.R. (2d) 1, 59 D.L.R. (4th) 449 (H.C.J.); supplementary reasons 69 O.R. (2d) 447 (H.C.J.); *Re Ontario Public Trustee and Toronto Humane Society* (1987), 60 O.R. (2d) 236, 50 D.L.R. (4th) 111 (H.C.J.) (subsequent references are to 60 O.R. (2d)); *Re Incorporated Synod of Diocese of Toronto and H.E.C. Hotels Ltd.* (1987), 61 O.R. (2d) 737, 44 D.L.R. (4th) 161 (C.A.); *Roman Catholic Archiepiscopal Corp. of Winnipeg v. Ryan* (1957), 12 D.L.R. (2d) 23, (*sub nom. Canada Trust Co. v. Roman Catholic Archiepiscopal Corp. of Winnipeg*) 26 W.W.R. 69 (B.C.C.A.); *Re French Protestant Hospital and Attorney General*, [1951][Ch. 567, [1951] 1 All E.R. 938 (subsequent references are to [1951] Ch.); and *Liverpool & District Hospital for Diseases of the Heart v. Attorney General*, [1981] Ch. 193, [1981] 1 All E.R. 994 (subsequent references are to [1981] Ch.).
>
> The American situation is much the same. See *Somerland of Santa Barbara, Inc. v. County of South Barbara*, 31 Cal. Rptr. 131 (Cal. Dist. Ct. App., 1963) ("[A]ll property held by a benevolent corporation is impressed with the charitable trust"), cited in "Developments in the Law–Nonprofit Corporations" (1992), 105 Harv. L. Rev. 1578, at 1593. The Model Act, however, states unequivocally that directors are not trustees: *supra*, note 24, §8.30(e). See, also, L.S. Sealy, "The Director as Trustee,"[1967] Cambridge L.J. 83.

[43] *Ibid.* at 457. The OLRC recommends against the direct application of trust law concepts or trust law terminology to the nonprofit ("charitable") corporation, its directors, or its property: *ibid.* at 460.

> charitable purpose corporations, courts have felt the need to adopt one or more of these three fictions.

[33] Even if trustee duties were to be imposed directly on nonprofit directors and officers with respect to property settled on the corporation in trust, it would be quite another matter to burden them with trustee duties with respect to all property owned by the corporation.

d. Caution

[34] The application of trust principles to corporate directors should be approached with caution. After all, in Alberta as in Ontario, "the vast majority of ... charities ... are well-run, honest, efficient organizations playing a vital function in the social matrix of the province."[44] The law should not "have the effect of discouraging participation in such organizations by the very people who might be most valuable to them: successful, experienced individuals whose community spirit nevertheless stops short of putting their financial security, and that of their families, at risk."[45] Placing trustee obligations on the directors of nonprofit entities may pose "significant problems in the areas of remuneration, indemnities and liability insurance, among others."[46] It may also place them "in the position of possibly having to make frequent application to the courts for approval of actions that had previously been thought to be well within the powers of the board of directors of such charitable corporations."[47] In making law reform decisions, care must be taken to avoid unwarranted consequences such as these.

4. Shortcomings in regulation of nonprofit entities

[35] Courts importing some of the restrictions or controls that accompany charitable trusts may have perceived a lack of proper regulation of charitable activity carried on by nonprofit corporations. The corporate form is well-suited to for-profit business. However, although there are a great many similarities between business corporations and nonprofit

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[44] William I. Innes, *supra* note 9, at 2.

[45] *Ibid.* at 2-3.

[46] *Ibid.* at 8.

[47] *Ibid.*

corporations, there are also a significant number of important differences. The OLRC identifies two principal differences:[48]

> First, the nonprofit corporation does not have a constituency equivalent in influence and interest to shareholders to monitor the performance of management. Second, due to the fact that nonprofit corporations pursue a diverse range of nonprofit purposes, the success or effectiveness of a nonprofit enterprise is often not easily gauged and, therefore, the task of evaluating the performance of management and holding them accountable for errors is usually more difficult.

5. Distinction between organizational form and nonprofit activity

[36] The OLRC distinguishes issues relating to organizational form from issues relating to nonprofit activities undertaken through a charitable purpose trust, a nonprofit corporation or an unincorporated association. In resolving issues relating to organizational form, the OLRC looks to the basic area of law from which the form is derived. In resolving issues relating chiefly to the charitable function of the form, the OLRC chooses rules that are best for charity and applies them, subject to necessary but minor variations, in a way that is identical whatever the organizational form. Applying this distinction to the investment issue, one might choose (as does the OLRC) to impose a prudent investor standard on nonprofits entities without altering the nature of the relationship between the corporation and its directors and without changing the duty owed by the directors to the corporation.

6. Classification of nonprofit entities

[37] Some jurisdictions divide nonprofit entities into sub-classes. The divisions invite questions about different legal treatment. Various factors influence these classifications. They include: the locus of control and sources of financing; the destination of benefits; and the particular nonprofit purpose.[49]

[38] As has been seen, in Alberta the *Companies Act* distinguishes associations formed "for the purpose of promoting art, science, religion, charity or any other useful object" from associations formed "solely for the purpose of promoting recreation among its members." The registrar may impose conditions on the former but not the latter.

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[48] OLRC 1996 Report, *supra* note 8, at 453.

[49] *Ibid.* at 230-234.

[39] In Ontario, the classification scheme recommended by the OLRC centres on five principal nonprofit purposes: religion, charity, politics, mutual benefit, and a catch-all "other."[50]

[40] In Saskatchewan, the *Nonprofit Corporation Act*[51] prescribes rules for charitable corporations and membership corporations. The distinction takes into account the source of support for the activities (the members or the public), the sources of financial support and how the surplus is distributed upon dissolution. A membership company carries on activities that are primarily for the benefit of its members and is supported by its members through fees, donations, loans or any combination of these. In contrast, a charitable organization carries on activities that are primarily for the benefit of the public and may solicit donations from the public, receive government grants in excess of 10% of its yearly income or register as a charity within the meaning of the *Income Tax Act*. Unless directed otherwise by limitations of gift or corporate constating documents, a charitable corporation "may invest its funds only in shares, debentures, bonds, mortgages or other financial instruments in which trustees are permitted to invest" whereas a membership corporation "may invest its funds as its directors think fit." The limitation fixes a default investment standard; it does not render the corporation or directors trustees.

[41] Other examples are available.[52]

C. Reasons for Wanting Reform

[42] The question here is: what problem(s) would the imposition of an investment standard on nonprofit entities correct?

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[50] *Ibid.* at 234.

[51] S.S. 1995, c. N-42.

[52] See, e.g.: Manitoba Law Reform Commission, *Trustee Investments: The Modern Portfolio Theory* (Winnipeg:MLRC, 1999); British Columbia Law Institute Trustee Act Modernization Committee, Report No. 6 – *Trustee Investment Powers* (Vancouver, BCLI, 1999).

[43] The OLRC lists several regulatory objectives of the provincial law. The objectives, which are complementary, are "informed by a long-held respect for the work of the [nonprofit] sector and for the charitable intentions of donors."[53] The list includes:[54]

(1) to facilitate charity by making available to it adequate legal forms;
(2) to protect charity from fraud and waste;
(3) to aid in the pursuit of charitable purposes by compelling, in appropriate cases, charitable fiduciaries to fulfil their duties of loyalty and prudence;
(4) to police the eligibility of entities for fiscal privileges; and
(5) to foster the health of the nonprofit sector so that it is available to collaborate in the pursuit of government ends.

The OLRC concludes states that "what is truly of concern to the [nonprofit] sector, its financers, and the government [is] the *apparent* lack of management accountability in the sector ... to whom and how is management of a nonprofit entity accountable, and how effective are the accountability techniques in controlling for disloyalty and inefficiency?"[55] In the for-profit business sector, "the profit motive of shareholders and other owners constitutes a very strong incentive for such owners to ensure that the managers of *their* enterprises maximize *their* profits."[56] The situation differs for nonprofit entities. Here, "there is no one with a self-interest strong enough to induce them to establish accountability mechanisms as effective as these."[57]

[44] The *apparent* lack of management accountability may well be the concern underlying the request for ALRI to recommend the imposition of an investment standard on nonprofit entities and place directors and officers in the position of trustees with respect to the exercise of this standard. After all, as stated in our Report No. 80 on *Trustee Investment Powers*, the purpose of restricting the investment powers of trustees is to prevent them from exposing the trust capital to undue risk. *Apparent* is a significant word. As will be seen, the funds managed by nonprofit entities are subject to a good deal

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[53] OLRC 1996 Report, *supra* note 8, at 386.

[54] *Ibid.*

[55] *Ibid.* at 235.

[56] *Ibid.*

[57] *Ibid.*

of regulation, although, admittedly, that regulation does not do much to control investment powers and practices.

[45] Another possibility is that persons donating funds to nonprofit entities want greater assurance that the funds will be used to meet the objectives of the nonprofit entity. At present, we have no information about investment practices contributing to the misuse of funds by nonprofit entities, or about donors being dissatisfied with the conduct of nonprofit entities in this respect. Inquiries made to the government officials responsible for corporate and charitable fundraising (persons to whom complaints are likely to be made) came up empty. These officials had not heard of this as a problem (with the exception, post September 11th, of media concerns about the lack of restrictions on the use of charitable fundraising to support terrorist activities).

[46] Yet another possibility is that the directors and officers of nonprofit entities desire certainty about the standard they should be meeting in order to avoid breaching their obligations and risking liability. We have not surveyed the directors and officers of nonprofit entities for their views. However, we would be surprised to learn that volunteer directors want to risk greater personal liability than the paid directors and officers of for-profit corporations.[58]

D. Regulation of Funds Held by Nonprofit Entities

[47] The funds in the coffers of nonprofit entities come from a wide variety of sources. They include donations from individuals and corporations, grants from public or private foundations, gaming proceeds, the sale of goods and services (subject to the limitations placed on the participation of nonprofit entities in for-profit business activities) and membership fees.

[48] In many cases, the law regulates the way in which the funds are to be managed and the use that may be made of them.

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[58] Regarding the liability of directors of business corporations, see Susan Barkehall Thomas, "When is a Stranger a Constructive Trustee?" (2001), 39 *Alta. L.R.* 453. Blair and Stout contrast conventional theory governing for-profit corporations with more recent theory that postulates accountability to a wider audience than shareholders and other- rather than self-interested behaviour on the part of directors: Margaret M. Blair and Lynn A. Stout, "Director Accountability and the Mediating Role of the Corporate Board" (2001) 79 *Washington University Law Quarterly* (forthcoming), Georgetown Law and Economics Research Paper No. 266622; UCLA, School of Law Research Paper No. 01-14.

1. *Trustee Act*

[49] Donations may come to a nonprofit entity with or without conditions attached. In some cases, the person making the donation will stipulate the use to be made of the funds in a way that establishes a trust. Where the donor defines the trustee investment powers, those directions govern. Where the donor is silent, the donated funds are subject to the trustee investor powers stipulated in the *Trustee Act*[59] and considered in Report No. 80. As stated previously, the *Trustee Act* also applies where other statutes incorporate it by reference.[60]

[50] The law determining when a trust applies is complex and confusing. For present purposes, it is sufficient to accept that trust law applies where that law finds that a trust exists. In this situation, the nonprofit entity must honor the terms of the trust as a matter of *trust* law.

2. Contract law

[51] A public or private foundation may grant monies subject to conditions of a contractual nature. If the grant does not contain investment conditions, the law could provide that the prudent investor standard apply by way of default.

3. Corporate law

[52] Often, the donor may simply write a cheque to the organization without giving directions for the use of the funds. This money will become part the nonprofit entity's general revenue. Although no express strings accompany the donation, the donor ordinarily expects the money to be used to help the entity accomplish its objectives. Here, the donor is relying on corporate law to ensure that the funds are handled appropriately: the nonprofit entity is the owner of the funds, but the directors of the company or society owe fiduciary duties to the company or society; one of those duties is to make decisions that support the entity's objectives. The director's investment powers could be governed by the nonprofit entity's constating documents. In the case of a society, provided that the "legitimate objects" test of the *Societies Act*,[61] s. 13(2) is met, the by-laws could authorize

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[59] *Supra* note 2.

[60] *Supra* note 4.

[61] *Supra* note 5.

the directors to invest the society's funds in accordance with the principles of prudent investment, or in accordance with s. 5 of the *Trustee Act*, or in accordance with any other reasonable investment approach. Similarly, the memorandum and articles of a nonprofit entity incorporated under the *Companies Act*[62] could provide ample investment powers to the directors. Even if the constating documents of a society or company were to provide them with ample investment powers, it could be argued that the directors should be subject to a statutory standard of prudence, regardless of what those documents say. That would raise some interesting policy issues as to the extent to which the legislative prudent investor standard should "trump" the will of the nonprofit entity's members.

4. *Charitable Fund-raising Act*

[53] Another piece of legislation that regulates the handling of funds is the *Charitable Fund-raising Act*.[63] Registration as a charity under this Act is required to conduct fundraising activities. The Act defines a "charitable purpose" to include any philanthropic, benevolent, educational, health, humane, recreational, religious, cultural or artistic purpose. The Act applies to both incorporated and unincorporated entities, as well as to "any person asking for contributions to be used for a charitable purpose or charitable organization, even if that person is not connected to any charitable organization, by persons on behalf of a registered entity."[64] As explained in government literature, this Act "lays out the rules that must be followed when charities ask Albertans for donations":[65]

> These rules make sure that people who are asked to contribute to charities or for charitable causes:
>
> - have enough information to decide whether or not to give, and
> - are protected from fraudulent, misleading or confusing requests for contributions.

Registration is required only if a charity intends to raise, or does raise, more than $25,000 in gross contributions in its financial year.

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[62] *Supra* note 5.

[63] *Supra* note 36.

[64] Alberta Government Services, Consumer Services Division, *Consumer Tips: Information for Charities and Donors: The Charitable Fund-raising Act* (June 2000).

[65] *Ibid.*

[54] Among other information, the application for registration must include: the organization's objectives, or the purpose of the charitable fundraising; and answers to questions relating to the suitability of a person to make solicitations or deal with contributions. Registered charities must keep detailed financial records for three years. Persons soliciting donations must give potential donors basic information about the organization, and the use that will be made of donated funds. Certain additional information must be provided if anyone requests it. If requested, donors must receive receipts for all cash contributions. Standards of practice under the Act came into effect April 1, 1999. The standards were developed in consultation with charities and fundraising businesses.[66] Registered charities agree to comply with them. Standard 6 (there are 8 in all) provides:

> Charitable organizations must, to the best of their ability, ensure that contributions are used in accordance with donors' intentions and obtain the explicit consent of a donor or the donor's representative before altering the conditions of a gift.

[55] An unhappy donor can apply to the Court of Queen's Bench for an order requiring the charity to return the contribution, or amount equal to it; use the money for the purpose for which it was donated; or make a public declaration about the use or misuse of contributions.

[56] The Act does not specify that the monies are to be held in trust. It does impose a trust on those collecting the funds in favour of the organization raising the funds.

5. *Gaming and Liquor Act*

[57] The *Gaming and Liquor Act* provides for the licensing of bingos, casinos, pulling tickets and raffles. Ordinarily, gambling is an offence under the *Criminal Code*.[67] However, section 207 of the *Criminal Code* permits the Lieutenant-Governor of a

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[66] In addition to registered charities, the Act regulates the activities of fundraising businesses. A fundraising business "is one that is paid to ask for contributions on behalf of a charity, or that manages or is responsible for solicitations made by charities, or on their behalf. This includes contracted companies who conduct door-to-door fund-raisers or provide telemarketing services." *Ibid.*

[67] Criminal Code, R.S.C. 1985, c. C-46, ss. 197-208.

province to license gaming for charitable purposes. The Alberta Legislature has delegated this authority to the Alberta Gaming and Liquor Commission (AGLC).[68]

[58] The AGLC requires applicants for licences to stipulate the intended use of funds. Completed financial reports, with supporting documents, must be returned to the AGLC within sixty days from the time they are forwarded to the licensed entity. The funds raised must be kept in separate gaming accounts, or one consolidated gaming account, until spent on approved uses. Payments out must be by cheque. The licence records (including banking information) must be kept for two years after the date the licence expires, and the records are subject to inspections by the AGLC.

[59] Of interest for our purpose is the Commission policy allowing the investment of gaming proceeds that are not required immediately. Such proceeds "may be put into a separate interest-bearing account, or be used to buy short-term deposit certificates. All interest becomes part of gaming revenue and must be reported on financial reports."[69]

6. *Income Tax Act* (Canada)

[60] As stated previously, the federal government plays a dominant role by granting tax-exempt status to nonprofit and charitable organizations and allowing income tax deductions for charitable donations. These benefits motivate nonprofit entities to seek registration under the *Income Tax Act*[70] and to comply with the requirements of that Act in order to maintain their charitable status and avoid the sanctions for noncompliance set out in the Act.

7. Special Acts

[61] Special Acts establishing corporations, or Regulations promulgated under them, may contain their own regulatory provisions. In Alberta, the following legislation refers to prudent investment and may include enforcement provisions:[71] *Credit Union Act*,

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[68] *Gaming and Liquor Act*, R.S.A. 2000, c. G-1.

[69] Alberta Gaming and Liquor Commission, *General Information on Gaming Licences* (March 2001, Form LIC/GAM 5478)(01/03).

[70] *Supra* note 13.

[71] This list was obtained by searching QL RSAT – Entire-Act-Version of statutes (current to October 15,

(continued...)

R.S.A. 2000, c. C-32.; *Glenbow-Alberta Institute Act*, R.S.A. 2000, c. G-6.; *Insurance Act*, R.S.A. 2000, c. I-3 ; *Loan and Trust Corporations Act*, R.S.A. 2000, c. L-20.; *Electric Utilities Act – Balancing Pool Regulation*, AR 169/99 (consolidated up to 39/2001); *Employment Pension Plans Act – Employment Pension Plans Regulation*, AR 35/2000 (consolidated up to 218/2000); and *Regional Health Authorities Act – Regional Health Authorities Regulation*, AR 15/95 (consolidated up to 59/2001).

8. Government foundations

[62] Acts that establish government Foundations also play a regulatory role with respect to the nonprofit entities that are eligible to receive grants.[72]

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[71] (...continued)
2001) and ARGT – Full text of regulations (current to AR 183/2001 September 20, 2001).

[72] Alberta Foundations located in a QL search are: *Advanced Education Foundations Act*, R.S.A. 2000, c. A-5; *Alberta Foundation for the Arts Act*, R.S.A. 2000, c. A-19; *Alberta Heritage Foundation for Medical Research Act*, R.S.A. 2000, c. A-21; *Alberta Heritage Foundation for Science and Engineering Research*, R.S.A. 2000, c. A-22; *Alberta Sport, Recreation, Parks and Wildlife Foundation Act*, R.S.A. 2000, c. A-34; *Health Foundations Act*, R.S.A. 2000, c. H-4; *M.S.I.. Foundation Act*, R.S.A. 2000, c. M-24; *Persons with Developmental Disabilities Foundation Act*, R.S.A. 2000, c. P-9; and *Wild Rose Foundation Act*, R.S.A. 2000, c. W-8.

PART III – ALRI Project Selection Criteria Applied

A. Need for reform

[63] The first consideration is whether there is a clear law reform issue arising out of a problem that needs to be addressed. From our preliminary research, we know that nonprofit entities are not subject to any generally-imposed investment standard. However, we lack data suggesting that the current investment practices of nonprofit entities are inappropriate. We have no information to suggest that donors have concerns. Government officials involved in the regulation of corporations and charitable fundraising indicate that they have not been made aware of the lack of an investment standard as a problem. The directors and officers of nonprofit entities may wish to know what their responsibilities are with more certainty. We have not surveyed them for their views but, as stated previously, we would be surprised to learn that volunteer directors want to risk greater personal liability than the paid directors and officers of for-profit corporations.

[64] The driving concern may be that nonprofit entities lack sufficient regulation as a legal form. We have discovered that, although the law is fragmented, in fact the activities of nonprofit entities having public purposes (charitable activities, broadly interpreted) are quite widely regulated. The regulation comes from the registration of nonprofit entities for income or other tax exemption purposes, public fundraising restrictions, restrictions imposed by individual or corporate funders and laws or policies that apply to public funding sources (AGLC, foundations established by government).

B. Community Interest

[65] Introducing an investment standard would fill in a gap in the law governing nonprofit entities. However, as far as we have been able to ascertain, neither the nonprofit community nor persons dealing with this community have expressed a widespread concern. In short, we have not detected any strong community interest in reform. Our past experience in recommending the reform of the law governing the form of nonprofit entities has shown that the nonprofit constituency likes, and expects, to be consulted. However, the views expressed tend to be fairly diverse.

C. Project Appropriate for ALRI

[66] A project in this area would be appropriate for a law reform agency to take on in the sense that it is involves considerations of law that are not likely to be dealt with by the political process. If the lack of an investment standard was raising concerns among government administrators, they might initiate reform action. However, administrators are unlikely to have the legal expertise necessary to fully consider the implications of the policy choices. As the preliminary research shows, many areas of law come into play, and sorting out the interconnections among them is complex.

D. Balance in Total Program

[67] At the present time, ALRI has a full program. Taking on a project on investment standards for nonprofit entities at this time would not assist the desired balance in our program among projects with the potential to make contributions both to technical areas of law and to areas of law involving social policy.

E. Demand on ALRI resources

[68] The law involved is complex, confusing and often ambiguous. From a policy perspective, consultation with the entities affected is essential. Given the breadth of knowledge required to do justice to the issue, we have concluded that the work involved in reaching a recommendation would not be commensurate with the effort which would have to go into the project. If the issue whether nonprofit entities should be subject to an investment standard is to be addressed, it would be preferable to include it in a wider examination of nonprofit and charitable law as Ontario has done.

F. Related Projects

[69] This issue was suggested by our project on Trustee Investment Powers. However, we think that the elements to be considered are sufficiently different to warrant independent treatment. As just stated, there may be a contribution to be made to a broader based research project.

G. Likelihood of Reform

[70] Our past experience with recommendations to unify the law governing the corporate nonprofit form leads us to conclude that reform in this area has a low priority for government. In Report No. 49, *Proposals for a New Alberta Incorporated Associations*

Act, we made recommendations for a new Act to replace the existing *Societies Act* and the *Companies Act*, Part 9. The recommendations were converted into Bill form and introduced in the Legislature. The Bill died on the order paper when members of the nonprofit entities complained that they had not been adequately consulted. The government took further consultation steps but, in the end, no legislative changes were made to the law. The idea of reform was simply dropped.

H. Informing Public Debate

[71] Our view that there is value in informing public debate on the issue has led us to share our preliminary research in the form of this Research Memorandum.

I. Conclusion

[72] As stated in Part I, the issue whether nonprofit companies and societies should be subject to the prudent investor rule raises considerations that reach beyond the scope of Final Report No. 80. In our view, the separate considerations require the designation of a separate project which would include undertaking the considerable research necessary to fully investigate the issue and conducting a broad consultation with volunteers and staff in the nonprofit sector and members of the public. These and the other reasons set out in Part III have led us to the decision not to take this topic on as a project at this time.

APPENDIX A

Sample Cash and Investment Management Policy of an Alberta Nonprofit Entity

THE BOARD OF DIRECTORS RECOGNIZES THAT EFFECTIVE CASH MANAGEMENT IS ESSENTIAL TO GOOD FISCAL MANAGEMENT. AS INVESTMENT INTEREST IS A VIABLE AND MATERIAL SOURCE OF REVENUE TO [nonprofit entity], [nonprofit entity]'S INVESTMENT PORTFOLIO SHALL BE DESIGNED AND MANAGED TO MAXIMIZE THIS REVENUE SOURCE, TO BE RESPONSIVE TO PUBLIC TRUST, AND TO BE IN COMPLIANCE WITH LEGAL REQUIREMENTS AND LIMITATIONS.

INTENT AND INTERPRETATION

This investment policy governs the investment of all financial assets of [nonprofit entity]. Investments shall be made with the primary objectives of:

- Safety and preservation of principal
- Maintenance of sufficient liquidity to meet operating needs
- Maximization of yield on the portfolio
- Public trust from prudent investment activities.

All investments shall be designed and managed in an ethical and responsible manner and in accordance with provincial and federal legislation.

Ethics and Conflict of Interest

Directors, officers or employees involved in the investment process must disclose any personal business activity or financial/investment positions that could be related to the performance of the investment portfolio or that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions.

Indemnification

Directors, officers or employees, acting in accordance with written policies and procedures and exercising due diligence, shall not be held personally responsible for a specific security's credit risk or market price changes, provided that these deviations are reported immediately and the appropriate action is taken to control adverse developments.

PROCEDURE

1. Funds not currently required for immediate operating and/or capital needs may be invested.

2. Cash balances from all sources may be consolidated to maximize investment earnings. Investment income will be allocated to the various sources based on their respective participation and in accordance with generally accepted accounting principles.

3. Allowable investments include and are limited to:

   Cash and equivalents:
   - Government of Canada Treasury Bills
   - GIC's, cash or deposit receipts, deposit notes, certificates, acceptances and other similar investments issued or endorsed by any chartered bank to which the Bank Act (Canada) applies.

   Bonds:
   - Government (federal and provincial) bonds
   - Corporate bonds (limited to investments rated no lower than single-A and not to exceed 25% of the investment mix).

4. The bond portfolio will be managed by a Financial services firm and signing authority with that firm shall be in accordance with [nonprofit entity]'s policy on signing authority.

5. Investments will be matched with anticipated cash flow requirements. The investment portfolio will be managed in such a way as to mitigate against the vagaries of interest rates and as such, no portion of the portfolio will be invested for a term which exceeds five (5) years.

6. Ideally, investments will be bought with a "buy and hold" strategy in order to maximize return. However, investments may be sold before they mature in the following instances:

   - A security with declining credit may be sold early to minimize potential loss of principal
   - A change in securities which would improve the quality, yield or target duration of the portfolio
   - Liquidity needs of the organization require the investment to be sold.

7. The [nonprofit entity] Board Finance and Audit Committee will regularly receive reports on the investment portfolio and their rate of return. The report will include: type of investment, purchase date, purchase amount, maturing amount, maturity date and interest rate.

Authorized Signature:	Effective Date: Cancels & Supersedes: Date of Last Review:

Appendix B

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