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## **Organizing an Illinois Not for Profit Corporation**

A brief description of the forms and governing documents associated with the formation and operation of an Illinois Not for Profit Corporation.

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NOTE: This Article is extracted from a more comprehensive treatise on organizing Illinois not for profit corporations, Chapter One of the Not For Profit Corporation manual published by the Illinois Institute for Continuing Legal Education published 2010.

## 1. [1.31] Articles of Incorporation

The organizational document is Secretary of State Form NFP-102.10, which sets forth the organization's articles of incorporation. See §1.116. This document, when approved by the Secretary of State, is the corporate charter, giving legal existence to the new entity. Articles of incorporation are not difficult to prepare, but care should be exercised to complete them properly, since they become the cornerstone of the organization and are frequently asked for, to establish corporate legitimacy and credibility. In other words, the articles create a first impression on grant makers and government agents.

Form NFP-102.10 must be prepared in duplicate, neatly and legibly, using black ink only, and must include the incorporators' signatures. (All documents filed with the Secretary of State must have original signatures.) The Secretary of State will return documents that cannot be microfiched for any reason. The writing must use characters of the English alphabet, Arabic or Roman numerals, or other symbols capable of being readily reproduced by the Secretary of State's Office. See NFPCA §104.05.

### *a. [1.32] Naming the Corporation*

Article 1 of the articles of incorporation sets forth the name of the new not-for-profit corporation. Naming the organization can be a challenge, especially for charitable organizations. Corporations registered in Illinois must have names that are distinguishable from each other. NFPCA §104.05 gives the Illinois Secretary of State limited discretion to decide whether a name is distinct. Because certain words are popular in describing churches and charities, these entities often experience considerable difficulty in obtaining a name that is both suitable and available. While the Secretary of State's website offers a fairly complete listing of already-registered names, only a check with the Illinois Secretary of State's Office at 217-782-9520 will assure the availability of a name chosen by an organization's founders. The Secretary of State's website also includes valuable information about the guidelines used to determine distinguishable names. After July 2001, the Secretary of State was authorized to require that the letters "NFP" be included at the end of a nonprofit corporate name unless the name itself clearly identifies the charitable purpose of the organization. The statute does not define "NFP" but we may assume the legislature intended it to mean "Not For Profit". For example, if the new name is to be "ABC Charities" or "XYZ Church" the reference to NFP is not required. However, if the name is more ambiguous, such as "Loving Care Services" or "Chicago Homes for People" the Secretary of State will return unfiled Articles until the "NFP" is included with the name. It is sometimes difficult to predict how the persons working with the Secretary of State will react to a given name. The best thing to do is to call the corporate services at the Secretary of State and inquire about the "NFP" requirement before filing a certain corporate name.

Any organization that will invest substantial resources in the goodwill of a corporate name should do a complete name search on a national trademark/service mark data base. A qualified trademark can be protected by federal registration. Likewise, Illinois law provides a more limited trademark protection. The Trademark Registration and Protection Act, 765 ILCS 1036/1, *et seq.*, provides protection limited to Illinois. Registration under the Illinois Act provides conclusive evidence as to when an organization started using a protected name and may be valuable when trying to establish priority of use of a name or mark. In any case, a comprehensive search may alert the founders to the fact that the name they have chosen or potentially deceptive similar name is already in use elsewhere and may present

a future conflict if two or more similarly named organizations try to operate in an overlapping jurisdiction.

*b. [1.33] Registered Agent and Address*

Article 2 of the articles of incorporation lists the name and address of the organization's initial registered agent and registered office. NFPCA §105.05 requires every authorized corporation in Illinois to maintain a registered agent at an address within the state. Choosing the person who will serve this function is an important decision. The registered agent receives official correspondence from the Secretary of State and is designated by law to receive service of process in all legal actions. Not-for-profit corporations can be and often are dissolved because their registered agent fails to process annual reports for the Secretary of State. This problem usually comes to light when an organization is asked to provide proof that it is in "good standing" in order to receive a major government contract or grant and discovers that it has been administratively dissolved by the Secretary of State. The effort to reinstate the organization can be costly, in terms of both time and expense, and sometimes can result in loss of a contract or grant, due to deadline pressures and credibility issues.

When preparing the articles of incorporation, a registered agent should be chosen who has a stable address, is aware of the types of legal notices that may be received in that capacity, and will efficiently process annual report duties. The registered agent may be an individual or a specially qualified corporation, but it cannot be the not-for-profit corporation itself. Several service corporations in Illinois will act as registered agent for an annual fee. Often legal counsel for the corporation will serve as registered agent, so that legal notices will be immediately served on the person who will be required to act on them. As with directors, the address of the registered agent must be a specific street address in Illinois and cannot be a post office box. The principal business address of the corporation may be the registered office, but, in that case, it must also be a principal location of the person who is identified as the registered agent.

*c. [1.34] Initial Board of Directors*

Article 3 of the articles of incorporation identifies those who will serve as initial directors of the organization. NFPCA §108.10(a) requires that three or more initial directors must be named in the articles of incorporation. After a not-for-profit corporation has been chartered, its bylaws will provide for a prescribed number of ongoing directors.

Directors must be natural persons who can interact with each other in order to formulate policies and make corporate decisions; a corporation, partnership, trust, etc., may not be a director. There is no legal requirement that a director be an Illinois resident although bylaws may specify such residency. Directors may reside anywhere, subject only to any qualifications that are set in the articles of incorporation or bylaws. Many Illinois not-for-profits have no directors or officers located in Illinois.

The articles of incorporation must include the name and residential address of each initial director. NFPCA §102.10(a)(5). While some directors do not want their private residence listed on a document of public record, if the Secretary of State identifies a post office box or an office, rather than a home, address, the articles will be returned to be corrected.

The articles of incorporation do not describe any initial officers of the corporation because drafting Form NFP-102.10 precedes both the act of incorporation and the first meeting of the board at which officers will be elected. The Secretary of State will reject any articles of incorporation that refer to an initial director as an officer, as well.

*d. [1.35] Corporate Purposes*

Article 4 of the articles of incorporation sets forth a statement of the purposes for which the corporation is organized. NFPCA §103.05 permits a wide variety of corporate purposes that have been legislatively determined to enhance the well-being of the general public or some significant part thereof. Corporate purposes authorized by the Illinois legislature are diverse, and many are connected with special interests or social policy issues. Some, such as “charitable,” “civic,” and “scientific,” are vague and may include a multitude of qualified activities. Others are specific. The articles of incorporation must include at least one (but may include more than one) of these purposes. To simply reference “any and all the purposes allowed under the Act” will not suffice. The following is the list of thirty-two qualified not-for-profit purposes in Illinois.

- (1) **Charitable.**
- (2) **Benevolent.**
- (3) **Eleemosynary.**
- (4) **Educational.**
- (5) **Civic.**
- (6) **Patriotic.**
- (7) **Political.**
- (8) **Religious.**
- (9) **Social.**
- (10) **Literary.**
- (11) **Athletic.**
- (12) **Scientific.**
- (13) **Research.**
- (14) **Agricultural.**
- (15) **Horticultural.**

- (16) Soil improvement.**
- (17) Crop improvement.**
- (18) Livestock or poultry improvement.**
- (19) Professional, commercial, industrial, or trade association.**
- (20) Promoting the development, establishment, or expansion of industries.**
- (21) Electrification on a cooperative basis.**
- (22) Telephone service on a mutual or cooperative basis.**
- (23) Ownership and operation of water supply facilities for drinking and general domestic use on a mutual or cooperative basis.**
- (24) Ownership or administration of residential property on a cooperative basis.**
- (25) Administration and operation of property owned on a condominium basis or by a homeowner association.**
- (26) Administration and operation of an organization on a cooperative basis producing or furnishing goods, services, or facilities primarily for the benefit of its members who are consumers of those goods, services, or facilities.**
- (27) Operation of a community mental health board or center organized pursuant to the Community Mental Health Act [405 ILCS 20/0.1, *et seq.*] for the purpose of providing direct patient services.**
- (28) Provision of debt management services as authorized by the Debt Management Service Act [205 ILCS 665/1, *et seq.*].**
- (29) Promotion, operation, and administration of a ridesharing arrangement as defined in Section 1-176.1 of the Illinois Vehicle Code [625 ILCS 5/1-176.1].**
- (30) The administration and operation of an organization for the purpose of assisting low-income consumers in the acquisition of utility and telephone services. NFPCA §103.05(a).**
- (31) Any purpose permitted to be exempt from taxation under Sections 501(c) or 501(d) of the United States Internal Revenue Code [26 U.S.C. §170(c)], as now or hereafter amended.**
- (32) Any purpose that would qualify for tax-deductible gifts under the Section 170(c) of the United States Internal Revenue Code [26 U.S.C. §170(c)], as now or hereafter amended. Any such purpose is deemed to be charitable under subsection (a)(1) of this**

**Section. NFPCA §103.05(a)**

When describing corporate purposes in the articles of incorporation, this statement will become a key focus of the newly incorporated organization. Its directors will refer to the purpose statement when developing initial programs and services and as they promote public awareness of its goals and objectives. Major funding sources will form their first impressions of the organization by reading its purpose statement. For these reasons, if none other, this is not a good place to use overly general or vague language. For example, if an organization states in its articles that “the purposes are to be exclusively charitable and educational” but provides no other guidance, the statement of purpose will give directors no guidance in forming corporate policy, nor will potential grant-making foundations be able to decide whether the organization is acceptable under their guidelines.

A matter of concern to nonprofits operating in Illinois is the need to focus the corporation’s purposes as religious or charitable or educational. There is experience when working with the Illinois Department of Revenue that sales tax exemption and/or property tax exemption may be disaffected when the corporation’s purposes are too broad. The Illinois tax code designated these three categories (religious, charitable, educational) under distinct statutes. On several recent occasions, the agents of the Department of Revenue have challenged property tax exemptions, for example, of applicants seeking qualification as both religious and charitable. It seems that the underlying test for these two tax-exempt classifications may be in conflict in the official opinion of certain Department of Revenue determination specialists and some administrative law judges. Practitioners representing a “charitable” organization in Illinois are well advised to carefully consider the restrictive legal environment in Illinois when preparing the corporate purposes for an organization with broad altruistic intentions.

Some practitioners argue that a broad statement of corporate purpose allows future managers to change or expand corporate purposes without needing to amend the articles of incorporation. This may be true, but it just as easily will fail to control or limit the direction of future development. On the other hand, a limited statement of purpose may require a later revision as the organization’s scope and vision grow. The latter problem raises the question of what happens when funds raised for an entity’s narrow purpose are applied to another purpose. More than a charter amendment is required, as the IRS and the Illinois Attorney General may have to grant their approval to the change in use.

An example of a statement of corporate purpose is as follows:

**\_\_\_\_\_ is organized and operated exclusively for charitable purposes in accordance with §501(c)(3) of the Internal Revenue Code of 1986 (or the corresponding provision of any future United State Internal Revenue law and referred to below as the “Code”). More specifically the corporation is organized to provide a food pantry, homeless services, a “clothes closet,” and other beneficial services for low-income residents located in Westside neighborhood of Chicago. (Note: Be sure to avoid generalized purposes).**

This statement of purpose is qualified under the NFPCA: it provides clear guidelines to the organization’s founders and leaders during the organization’s lifetime; donors know what the organization will do with their money; and it sends the message that it will be organized and operated in accordance with IRS regulations for exempt organizations. However, because the geographic area is so limited, the statement of purpose will have to be amended if the organization wishes to enlarge its program or service area. For this reason, it may be wise to exclude the geographic restriction in the original articles.

The not-for-profit organization may seek to engage in professional services that are regulated by the Department of Professional Regulation, provide service programs licensed by other departments of Illinois government, or run degree-conferring schools that are regulated by the Illinois Board of Higher Education. Founders of such organizations must conform with statutory licensure requirements and limitations if they invoke them by the way they define their charitable purpose. If a not-for-profit intends to organize for purposes that may be similar to but outside the scope of those that are regulated, it must note that limitation in the statement of corporate purpose. For example, it is prudent to state, “The corporation will not operate a school or similar institution regulated by the Illinois State Board of Education,” if the not-for-profit intends its program to be educational but not within the definition of a school. These same issues apply to organizations providing low-income housing or other regulated activities. See §§1.11 – 1.21 above.

A final issue having to do with the purpose statement concerns the interface between state and federal exemption regulations. To be qualified under Code §501(c), corporate purposes must include enabling language if the purpose statement changes the organization’s classification for exemption purposes. For example, if a not-for-profit intends to be a “supporting organization” to another qualified §501(c)(3) organization, its purposes should specifically refer to the qualified organization it will support. A trade association should specifically identify the trade or business group being served. More detailed information about IRS requirements is provided in Chapter 2.

*e. [1.36] Other Provisions, Including Limitation of Authority or Special Powers*

Article 5 of the articles of incorporation allows the incorporators to include an addendum containing other provisions. Most drafters use this addendum to set forth special powers and limitations that will qualify the organization to seek IRS recognition as exempt from taxes. The special issues to be addressed are described in IRS Publication 557, Tax Exempt Status for Your Organization. The following is a paraphrase of language that has been accepted by the IRS for the past several years:

**ARTICLE 5**  
**Limitations of Corporate Authority**

**A. The Corporation, being organized exclusively for religious, charitable, and educational purposes, may make distributions to organizations that qualify as exempt organizations under §501(c)(3) of the Code.**

**B. No part of the net earnings of the Corporation shall inure to the benefit of, or be distributable to, its members, directors, officers, or other private persons, except that the Corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article 4 above.**

**C. No substantial part of the activities of the Corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the Corporation shall not participate in, or intervene in (including the publishing or distribution of statements concerning), any political campaign on behalf of any candidate for public office.**

**D. Notwithstanding any other provision of these articles, the Corporation shall not carry on any other activities not permitted to be carried on (1) by a corporation exempt from federal income tax under §501(c)(3) of the Code or (2) by a corporation contributions to which are deductible under**

**§170(c)(2) of the Code.**

**E. Upon dissolution of the Corporation, the Board of Directors shall, after paying or making provision for the payment of all of the liabilities of the Corporation, dispose of all of the assets of the Corporation exclusively for the purposes of the Corporation in such manner, or to such organization or organizations organized and operated exclusively for charitable, educational, religious, or scientific purposes as shall at the time qualify as an exempt organization or organizations under §501(c)(3) of the Code, as the Board of Directors shall determine. Any such assets not so disposed of shall be disposed of by the appropriate court of law of the county in which the principal office of the Corporation is then located, exclusively for such purposes or to such organization or organizations, as said court shall determine, which are organized and operated exclusively for exempt purposes.**

Paragraph E, the dissolution clause, is analogous to a last will and testament. It states that in the event of the termination of the organization, assets will go to another qualified §501(c)(3) organization. If the organization is a subsidiary of another exempt organization, or if the founders know of a specific existing tax-exempt organization that should take assets upon dissolution, then the practitioner should use the following paragraph instead:

**E. Upon dissolution of the Corporation, the Board of Directors shall, after paying or making provision for the payment of all of the liabilities of the Corporation, distribute all assets, both real and personal, to \_\_\_\_\_, being qualified as an exempt organization or organizations under §501(c)(3) of the Code, or if such organization or organizations have dissolved or are unwilling or unable to accept said assets under the conditions of §501(c)(3) of the Code, to another such organization or organizations organized and operated exclusively for charitable, educational, religious, or scientific purposes as shall at the time qualify as an exempt organization or organizations under §501(c)(3) of the Code, and shall use said assets exclusively for the purposes of the Corporation in such manner, or as the Board of Directors shall determine. Any such assets not so disposed of shall be disposed of by the appropriate court of law of the county in which the principal office of the Corporation is then located, exclusively for such purposes or to such organization or organizations, as said court shall determine, which are organized and operated exclusively for exempt purposes.**

In addition to IRS-mandated language, Article Five is a suitable place to insert other special powers or limitations. A corporation formed for a specific time-oriented purpose may include a provision for automatic dissolution at the end of its intended duration. In the absence of such a provision, the corporation's duration is presumed to be perpetual. Membership corporations may use this section to include special rights and powers reserved to their members, such as the rights to elect directors, to sell property, or to amend the articles of incorporation or bylaws. In addition, corporations organized to provide low-income housing or other federally-funded programs will need to include additional rights and responsibilities particularly tailored to satisfy applicable federal guidelines and to satisfy the more restrictive definition of "charitable activities" currently imposed in Illinois by the Department of Revenue.

*f. [1.37] Incorporators — Name and Address*

Article 6 of the articles of incorporation identifies the incorporators as the persons who sign the articles of incorporation and swear to the truthfulness of the information therein. NFPCA §102.05 requires no more than the signature of a single person who is 18 years of age. The incorporator need not be a resident of Illinois nor a resident or citizen of the United States. Many organizations will nevertheless designate several incorporators for symbolic reasons. Usually one of the founders will sign the articles and give his or

her personal address as the return address. The return address need not be a residence as in the case of the initial directors; usually, it is that of the lawyer. Legal counsel may act as the incorporator when founders want to expedite the incorporation process and forego the time spent obtaining signatures.

A domestic or foreign corporation may be the incorporator. In that case, the articles must be signed by the president (or vice president) of the corporation, and they must be verified and attested to by the corporate secretary (or assistant secretary).

*g. [1.38] Filing and Recording the Articles of Incorporation*

When the articles of incorporation are completed, they are filed with the Secretary of State's Office in Springfield. The filing fee is \$50, which must be paid by money order or cashier's or certified check. If an attorney files the articles, a check from the attorney's firm account will suffice. If the filer does not designate a return address for the filed articles of incorporation, the Secretary of State will return the document to the registered agent. Since July 1, 2001, in accord with PA 92-33, the certification requirements affecting the various documents filed under the NFPCA and processed by the Secretary of State have been amended. In nearly all situations in which the Secretary of State would be required to certify a document such as the articles of incorporation or the authority to conduct affairs in this state, there is no longer a "certification" process. The only "certification" process that remains under the NFPCA is the Certificate of Good Standing under 805 ICLS 105.113.15. Newly filed Articles of Incorporation will be returned with a notation at the top of the first page that the Articles have been "filed".

The Secretary of State's Office usually carefully reviews Form NFP-102.10 and its attachments and will return any document that does not comply with the NFPCA's specific requirements. The usual turnaround time by regular mail is four to six weeks (express mail will shorten the processing time, but only minimally). For an additional fee of \$25, the Secretary of State will expedite the filing process and reduce the time to a week or ten days. Occasionally, an incorporator will want articles of incorporation to be filed in less than a week. Corporation Service Company offices in Springfield and other large cities, can process the articles of incorporation within one day for a small fee. Call 800-634-9738 to discuss your need for expedited services. There are other similar agencies throughout the State that will assist attorneys with practical filing requests.

When the articles of incorporation have been filed and returned, they must be recorded in the office of the recorder *of the county in which the registered office of the corporation is located*. NFPCA §101.10(d)(3)(iv). While the principal business address of the corporation is *not* the required address to be used for this purpose, a second filing in that county is sometimes warranted. The recorded articles are a public record available to anyone who wishes to know the information contained on them. If there are subsequent changes of the registered agent or address and/or if the articles are amended, Form BCA-5.10/NFP-105.10, Statement of Change of Registered Agent and/or Registered Office (see §1.122), or Form NFP-110.30, Articles of Amendment (see §1.121), must also be filed with the same recorder after being filed with the Secretary of State. If the registered office is moved to another county, the notice (after being filed with the Secretary of State) is recorded in the new county of record along with a copy of the articles of incorporation including subsequent amendments. See §1.103 for a discussion of articles of amendment and §1.104 for a discussion of changing the registered agent and/or office.

*h. [1.38A] Filing a Restatement of the Articles of Incorporation*

Occasionally, a nonprofit corporation may have started without a proper statement of purpose or

perhaps the original articles of incorporation contain misinformation that cannot be effectively altered by a statement of correction under NFPCA §101.15. A restatement of the articles under NFPCA §101.30 may be recommended. The restatement is a modified form of amendments in which the entire articles are restated and become a complete statement of the corporate authority. See § 1.121A (sample Form NFP 110.30R). While the Secretary of State will retain the original articles of incorporation and all subsequent amendments as public record, the corporate entity may rely on the restated articles of incorporation as a complete document of authority. Unless expressly requested by an interested third party, the prior incorporation documents become irrelevant.

## **2. [1.39] Bylaws**

The NFPCA requires that all not-for-profits shall have a set of bylaws. See NFPCA §102.25. The statute is liberal in allowing flexibility on how bylaws are to be written and does not specify bylaw contents. Unless an organization's directors develop and approve its bylaws, the statute serves as a default set of bylaws. If they neglect their responsibility to draft appropriate bylaws, it behooves the directors to know the statute. In resolving a conflict among directors or other parts of a corporation, Illinois courts will look, first, to an organization's corporate charter and bylaws for guidance and, if they find none, then to the NFPCA.

Just as articles of incorporation are essential to establishing a not-for-profit's corporate status, its bylaws are essential to its governance structure. The proper formation of an Illinois not-for-profit corporation begins with a careful evaluation of the planned organizational structure and a skillful drafting of bylaws. Bylaws are certain to be an important document in an organization's long-term success. Without a good set of bylaws, the directors, officers, members, committees, advisory boards, and other agents of the corporation may have inadequate understanding of how authority flows through the organization. Using the metaphor of the human body, if the board of directors is the brain and the officers are the mouth, arms, and legs, then the bylaws are the skeleton, providing order and coordination of the relationships of the parts of the body.

The founders should develop a proposed set of bylaws before the initial meeting of the board. There will never be a better time to order the organization's essential functions. Once the initial directors have met and approved bylaws, the corporate structure becomes more precise, relationships and procedures become set, and participants take on a sense of entitlement to the powers, rights, and authority. Too often, the founders, ill-advised by legal counsel or seeking to save a few dollars by doing it themselves, adopt a set of "boilerplate" bylaws that are taken from a form book, the internet, or from some other organization the founders happen to know. It is problematic for a corporation to adopt bylaws that do not accurately reflect its true organizational structure. Leaders will naturally conduct corporate affairs in a manner that is natural to the group they lead, and boilerplate bylaws may be nonsupportive at best, or, at worst, openly antagonistic, to appropriate organizational structures and systems. When later disputes trigger power struggles within an organization's governing structure, poorly developed bylaws will worsen, rather than resolve them.

A basic form of sample bylaws is included below at §§1.131 – 1.147. This form of bylaws has been widely circulated among Illinois attorneys for years and has had consideration by the Corporation Law Committee of The Chicago Bar Association. The prior edition of this chapter included an essentially identical set of sample bylaws. It should be noted that these form bylaws serve only as a basic guide in structuring the organization; they should be revised to conform with the thoughtful intentions of the corporation's founders.

The complexity of a not-for-profit organization is limited only by the imagination of its founders and the practicality and skill of those who draft its bylaws. Their express language should describe the most important aspects of order and structure in the new organization. The following sections of this chapter are

intended to assist legal counsel and founders to decide what matters are important to this drafting process.

*a. [1.40] Statement of Corporate Authority and Registered Office*

The first article of the bylaws usually describes the source of corporate authority that empowers the corporation and may limit the location of operations (including the location of the principal corporate offices and the registered agent). This article may also state a limitation, if any is desired, on the organization's intended duration.

*b. [1.41] Statement of Purposes and Limitations*

The second article of the bylaws is, often, a restatement of the corporation's purposes and may expand the purpose statement in the articles of incorporation by adding some additional elements of process or methods for achieving corporate goals. A religious organization may include a statement of faith or similar articles of theological union. Social clubs, trade associations, and other member-oriented groups may want to articulate the benefits of membership in this article. The second article is also a suitable place to restate the essential limitations on powers of the corporation and its agents required by the IRS or state agencies. Some of these limitations are explained in §1.36 above concerning the articles of incorporation.

A reason for restating parts of the articles of incorporation in the bylaws is that, as a rule, bylaws are generally more likely to be circulated to the corporation's directors and officers and therefore more likely to be complied with in day-to-day operations. Also, it may be more practical to insert significant foundational policies and procedures in bylaws, rather than in the articles of incorporation, because bylaws are not a public record and can be amended with less administrative process. Many organizations insert a complete mission statement at this point in the bylaws. Such guidelines may be invaluable to future directors who deal with corporate priorities.

*c. [1.42] Special Limitations on Authority or Activities*

Another article should include a recitation of those limitations of power or activities that have been placed in the articles of incorporation. As stated above in §1.35 above concerning statements of corporate purpose, the Internal Revenue Code and several Illinois laws require that regulated tax-exempt not-for-profit organizations such as schools, social welfare or service programs, housing activities, etc., must include specific restrictions in the bylaws. Charitable organizations that own real estate in Illinois must have a bylaw that permits a reduction or waiver of fees or charges, if any, in cases of financial hardship as a condition required for property tax exemption, and such a provision may be included in this article as well. See 35 ILCS 200/15-65(c). For example, the author ordinarily uses the following bylaw provision when organizing a charitable organization.

**ARTICLE \_\_**  
**Waiver or Reduction of Fees**

**The Corporation, being organized exclusively for charitable purposes under Illinois law, shall strive to make its services and products available to the appropriate general public without undue obstacles to access. It is the general policy of the Corporation that any fees or charges associated with the charitable services or products of the Corporation shall be waived or reduced in accordance with each recipient's ability to pay. The administrative staff shall have the discretion to make such waivers or reductions, when appropriate, to ensure the maximum distribution of the Corporation's charitable**

**services or products. More specifically, the program fee schedules (if any) shall be set in accordance with 35 ILCS 200/15-65(c).**

This language is not necessary for schools and most qualified religious organizations such as churches, synagogues, temples, etc.

*d. [1.43] Membership*

NFPCA §107.03 permits not-for-profit corporations to have members or not, voting members or nonvoting members, members with votes on limited subjects, class voting, etc., as the drafters prefer, but the issue of membership must be addressed in the bylaws. Religious organizations, social clubs, trade associations, and the like are oriented to their members, who in turn elect a governing board. Social welfare organizations, on the other hand, usually are not member-oriented, and a self-perpetuating board of directors normally is appropriate for their governance. If there are no members, then this article should state that fact. If there are members, this article will describe who they are, what classes have been formed, assign their rights and responsibilities, and how they qualify to vote, detailing exactly what corporate matters are under member control and what are under the control of the board.

The popular culture of the United States assumes that membership organizations will operate democratically. The NFPCA is so oriented, but it allows each corporation to expand or contract membership rights according to its own internal policies. For example, under Illinois law, while a not-for-profit membership organization may put virtually all governing decisions to the members for a vote, it may permit members no vote in all or almost all issues of corporate governance. Generally, when it comes to managing the day-to-day affairs of the corporation, courts will side with management when authority is unclear. This is not true in situations involving questions or events that are of significance, such as electing directors, amending the articles, merger, and dissolution.

Not-for-profit organizations such as museums, public radio stations, or the opera may use memberships to encourage public participation and to advance fund-raising objectives. These corporations are not truly membership organizations like churches or clubs. It is essential that the bylaws of all organizations state all limits on membership. One might provide a token meeting each year for reporting to members, but it need not provide membership rights and privileges, except as may be necessary for marketing purposes.

The NFPCA allows a parent not-for-profit to create other subsidiary organizations by providing that it is to be the sole member of the controlled corporation.

(1) [1.44] Voting rights

Organizations with a membership that is to be participatory in corporate governance will want bylaws that clearly allocate members' rights and authority. Administering membership voting rights is a time-consuming and costly process. Such bylaws must be simple and straightforward, with limited discretion on the part of members and careful definition of their voting rights. For example, "Members shall be entitled to exercise one vote for each office up for election at the members' annual meeting, and shall have no other vote in the governance of the organization." If members are to have additional voting rights, specificity is warranted. Ambiguous bylaws are likely to be interpreted by a court of law in favor of the membership. *Westlake Hospital Association v. Blix*, 13 Ill.2d 183, 148 N.E.2d 471 (1958); *Harris v. Board of Directors of Community Hospital of Evanston*, 55 Ill.App.3d 392, 370 N.E.2d 1121, 13 Ill.Dec. 94 (1st Dist. 1977).

It is especially important to define the point at which a person becomes entitled to vote and under what conditions that person loses voting rights. Bylaws typically provide an application process followed by an acceptance or qualification date. For example, if dues are required of a voting member, the member's voting rights should be contingent upon timely payment of dues before the call of a members' meeting. The corporate secretary is expected to see that accurate and current membership lists are kept. The bylaws should have a clear and effective way to revoke membership rights for specific causes. Subjective and vague causes for termination are likely to embroil the organization in needless termination procedures and disputes as to whether cause exists.

Be aware that, under the NFPCA, members may vote by proxy, but directors may not. These two provisions should be clearly stated in the bylaws. The issue of proxy voting is usually considered a mundane part of the bylaws, but the use of proxy votes in corporate disputes can swing power and control. In *Natural Organics, Inc. v. National Nutritional Foods Association*, 302 Ill.App.3d 858, 706 N.E.2d 975, 236 Ill.Dec. 101 (1st Dist. 1998), the losing side in a corporate battle claimed that the winner was not allowed to use irrevocable proxies under the NFPCA, but the court ruled that irrevocable proxies were permitted.

## (2) [1.45] Membership classifications

Not-for-profit corporations may have more than one class of members. For example, a trade association may have different kinds of members organized into subgroups with varying degrees of rights and responsibilities. A social club may divide its members into classes based on seniority, achievement, or relationship. A church may have active and inactive members. There may be a requirement that classes be limited in number or in the percentage of votes they may cast. It is important that classifications are set forth in the beginning, as, later, some members may pit themselves against others.

### *e. Meetings of Members*

## (1) [1.46] In general

In a membership organization, one article in the bylaws should be devoted to members' meetings. Generally, the NFPCA places the responsibility for seeing that members' meetings are held on the board of directors, unless the bylaws specifically provide otherwise. The NFPCA does not require that there be a meeting of members entitled to vote and states that an organization's failure to hold an annual meeting of the membership neither works a forfeiture or dissolution of the corporation nor affects the validity of corporate actions. However, the NFPCA does authorize a qualified member to compel an annual meeting if the board fails or refuses to do so within a specified time. See NFPCA §107.05. A corporation may conduct a meeting not necessarily in a physical place but in cyberspace via "interactive technology, including but not limited to electronic transmission, internal usage, or remote communication, by means of which all persons participating in the meeting can communicate with each other." 805 ILCS 105/107.05. In other words, meetings of members can occur anywhere as long as a quorum of members can communicate simultaneously through electronic process. Presumably, the meeting could occur in an internet chat room as long as neither the articles nor bylaws prohibit such form of meeting. At this time, it would be appropriate for the members to meet and agree to conduct meetings in such alternative media in a normal face-to-face environment.

"Special meetings" of members are treated differently. NFPCA §107.05(c). In the usual case, the president or chairperson will call a special meeting for a designated purpose. The NFPCA defers to an organization's articles of incorporation or bylaws to guide this process. In the event that the directors refuse

to convene a meeting, and there is no bylaw provision on the issue, 1/20 of the qualified voting members may call a special meeting of the members. *Id.* Needless to say, such a meeting called by a minority of the membership may be disruptive to the corporation.

As of January 1, 2010, the NFPCA empowers voting members to take action by ballot without conducting a regular or special meeting provided that the corporation's articles or bylaws do not prohibit such action. Several conditions must be met for a membership's action without a meeting to be legally effective. First the ballot must be "in writing by mail, e-mail, or any other electronic means pursuant to which the members entitled to vote thereon are given the opportunity to vote for or against the proposed action." See § 107.10. Second, the action must carry the number of members that would constitute a quorum if the action were taken at a meeting. Third, the vote for the action must remain open for not less than five days from the date the ballot is delivered and for twenty days in the case of a removal of one or more directors, a merger, consolidation, dissolution, or other disposition of significant assets. Fourth, a notice in writing of the proposed action to be taken must be delivered to all of the members entitled to vote on the matter at least five days prior to the effective date of such informal action. Note that the voting member's signature is no longer required for the ballot to be effective under the NFPCA. However, the authors recommend continuing the practice in order to avoid possible contention if the decision is controversial.

## (2) [1.47] Notice

Good bylaws provide guidelines for the conduct of members' meetings, starting with notice provisions that comply with NFPCA §107.15. Under the NFPCA, notice of an annual or regular meeting of members must be delivered no less than 5 days nor more than 60 days before a meeting. Notices of special meetings must include the purpose of the meeting. If a meeting is called to remove one or more directors or to consider merger, consolidation, dissolution, or the alienation of corporate assets, notice must be delivered no less than 20 days before the meeting. Failure to give proper notice of a members' meeting may subject the actions taken at that meeting to being invalidated and enjoined by a member who did not receive adequate notice. Illinois case law on notices is meager. The NFPCA casts the notice requirements as mandatory, and bylaws cannot diminish a voting member's right to notice.

Managing the delivery of notice can sometimes be difficult. Historically, notice under the NFPCA was only accomplished by use of the mails or telegrams. Notice was deemed to be delivered when deposited in the mail box (the mail box rule) or when the telegram is delivered. However, the notice provisions were expanded to include various forms of electronic notification after June 26, 2002. Specifically, the "Definitions" section of NFPCA § 101.80 was amended by adding language at §101.80(g). " 'Delivered' for the purpose of determining if any notice required by this Act is effective, means . . . (4) Transmitted by electronic means to the address that appears on the records of the corporation as may be authorized and set forth in the articles of incorporation or the bylaws." 805 ILCS 105/101.80(g). As of January 1, 2010, the phrase "electronic means" was further defined to include an "e-mail address, facsimile number, or other contact information appearing on the records of the corporation." *Id.*

Caution should be used when a notice of meeting is permitted by telephone, facsimile, or e-mail. Each form of communication involves an address, but there must be a method to ensure that electronic notice has, in fact, been received. If a meeting involves a controversial subject matter, it may be difficult to prove that an absent but dissenting member actually received notice. The meeting results may be ruled invalid — after the fact. Bylaws that permit electronic notice should include some form of acknowledgment to the notice by the recipient. Be sure that electronic notice is acknowledged before the deadline for notice mailed in accord with the U.S. mail box rule.

Today, with telegrams no longer available in most parts of the United States and with technology increasing the available options, many organizations would prefer to deliver notice by sending electronic facsimiles, e-mail messages, posting notice in a public place, or merely making phone calls. Bylaws should be specific about what forms are accepted and how they should be used so that an unwarranted, casual approach to the issue does not take hold. For example, facsimile and e-mail messages must require responsive messages from the recipient to ensure that they have been received. Additionally, a corporation's bylaws may require members entitled to notice to sign an annual consent authorizing e-mail notices and provide a preferred e-mail address to use for e-mail notices. These consents can be kept by the corporation's secretary. Posted notices should be allowed only when some other form of notice is used to supplement the posting (or, as with residential cooperatives located in Cook County, it is permitted under the NFPCA). Telephone notice should never be used since there is no way to verify that notice was conveyed.

*f. [1.48] Federated Organizations with Chapters, Regional Affiliates, Etc.*

A statewide or nationwide organization that provides direct membership services or benefits often finds that it must divide into local and regional subunits in order to accomplish its purposes. Governance authority of the central board for such "federated" organizations must be clear and unequivocal. Multiple levels of leadership create potential conflicts of interest. Regional leaders have a tendency (some would argue, a responsibility) to assert what they see as the interests of their local members or constituents, even if they might be adverse to the interests of the national organization. Regional leaders also have a tendency to try to increase their influence over the organization. It is not uncommon for local chapters to become alienated from the national organization if the "national" is weak and for local leaders to exercise their autonomy to such an extent that they work against the interests of the national organization.

If there are several levels of authority inserted between individual members and the board, each level should be treated as a discreet authority, and the relation of each level to the one(s) above and below should be made explicit. For example, members might elect regional coordinators who in turn meet annually to elect directors and appoint officers. In this case, members will not actually vote for directors, but will choose delegates to act in their stead. Members in such an organization may attend annual conventions to receive benefits, but they will not have an annual meeting of members for any governance reason. Governance issues, such as notice and minutes of meetings, election of officers, liability of directors and officers, staff leadership, fiscal and programmatic accountability, etc., should be spelled out. The national board should retain authority to revoke its association with any subgroup and to remove uncooperative individuals from office.

Bylaws may be used to address specific administrative issues such as franchise rights, ownership of physical and intellectual property, ownership and use of membership lists, licenses and restrictions on the use of the national organization's name, logo, and goodwill, staff allocation and supervision, operational integration, etc. In addition, such property rights should be detailed in specific written agreements between chapters and the parent organization. Charters and certificates of accreditation, if used to delegate authority, should be detailed in documents that are separate from, but referred to, in the bylaws.

Some local chapters or councils are separately incorporated under local state law or operate as unincorporated entities, in either event, with only modest bureaucratic oversight and control. In this more horizontal federation model, it is especially important that the national organization's bylaws address those conditions under which independent local entities may participate in the larger organization. Many existing organizations leave the details of operating these independent agencies open, so that delegation of authority and allocation of tasks is experiential and word-of-mouth. When conflict or misunderstandings arise in

loosely governed organizations, there is no standard by which agreement can be achieved or a deadlock broken.

Authority in a federated entity is easier to allocate and limit at the early stages of corporate development than after affiliated entities have been empowered by inadequately considered structures or lack of leadership. Once that happens, it may be too late for national leaders to amend bylaws in order to correct the situation. If the central organization cannot remove obstructive local chapters, or if the authority to affiliate or withdraw rests with local leadership or delegates, then crisis situations may occur without effective remedy.

If the federated organization intends to obtain a group exemption from the IRS, it may be useful to refer to Rev.Proc. 80-27, 1980-26 Int.Rev.Bull. 49, as bylaws are being drafted, since the Revenue procedure provides specific organizational requirements and procedures that must be followed for the application for group exemption to be successful.

*g. [1.49] Board of Directors*

The bylaws should set forth the structure of a not-for-profit's governing board. Article 8 of the NFPCA provides that a not-for-profit's board of directors will be vested with managing the affairs of the corporation and lays out a structure that is consistent with this assumption. NFPCA §103.10 enumerates the general powers that are given by law to the corporation, and these powers need not be restated in the bylaws. However, an organization's directors must be aware of the list of powers, so that they may act in accordance with them.

NFPCA §108.10(a) also permits bylaws to authorize a range of directors, beginning with a base number and increasing by up to five additional directors (for example, from three to eight). Subject to what is said in the bylaws, the exact number of directors authorized within that range at any given time is determined by resolution of the board at any duly-convened meeting. Additional directors beyond the upper limit set forth in the bylaws requires an amendment to the bylaws. If the number of actual directors falls to fewer than three for any reason, the board may not lawfully function under the NFPCA. However, as a practical matter, it would seem necessary and appropriate for members capable of voting on directors or the two remaining directors to elect a third director and resume effective operations or to wind down corporate operations. In any case, all actions by a board of directors having less than three directors are questionable.

Though obvious, it is critical that the directors of a corporation actually be elected and replaced in strict accordance with the organization's bylaws. In *Muhammad v. Safiyya*, 363 Ill. App. 3d 407 (2006), plaintiffs argued that the holdover provision in § 108.10 applied to the controversy in an effort to contend that they were the legitimate directors of the board after the corporation failed to hold regular elections of directors. However, plaintiffs were unable to offer any evidence that an election of officers or directors had ever taken place since the corporation's inception. Rejecting the corporation's annual reports as prima facie evidence of election, and appointing a custodian to manage the corporation and appoint a new board, the court ruled:

The problem with the authority upon which plaintiffs rely in support of the holdover argument is that in each case, the relevant corporate body at some point did elect its directors and officers. Here there is no indication that any election. . . ever took place. It appears that the purported directors were merely assumed to be the directors and there was no need to ratify their status or elect successors. It occurs to us that, at some point, a

corporate body must elect its directors, not just name them at the time of formation and assume that they would hold office in perpetuity.

*Id.* at 416.

This case highlights the necessity of accurate record-keeping and proper corporate governance of the board.

The election and replacement of directors are thus critical processes that deserve careful attention. The following are three basic methods of perpetuating the board:

(1) [1.50] The self-perpetuating board of directors

The simplest form of selection is a self-perpetuating board of directors that chooses its own replacements. Important considerations for bylaws to address are the personal qualifications of prospective directors, election procedures, terms of service, and the procedure for removing directors.

Self-perpetuating boards can broaden the skill base and expertise of the directors by engaging in a thoughtful nomination process. Directors may be recruited for their management expertise, political access, financial acumen, marketing skills, or ability to support the cause. Charitable-service organizations may want to include a representative from the organization's beneficiaries, as a way to emphasize accountability to those they serve. In fact, many federal-and-state funded programs require a board to be substantially composed of residents from the community the organization serves. These "community boards" can at times hamper a board. A better approach may be to place representatives on board committees as non-director members. See §1.62.

(2) [1.51] Appointment by controlling organization

If the new organization is controlled by another entity, the bylaws should provide that at least some of the directors of the subsidiary or supporting organization are to be nominated, appointed, and/or elected by the board of the parent group. For example, a local library board might be appointed by the city managers, the directors of a research institute might be nominated by the elected board of a trade association that established it, church elders might elect the trustees of a controlled parochial grade school, etc.

A controlled board may run into additional problems if the identical same set of people serve on both boards. When two boards are coextensive and a conflict arises between the two corporations, legal paralysis may result because all directors will have identical interests. All of the directors may be affected by an unavoidable conflict of interest that could affect resolution of any legal problems. A better arrangement is to have two or three directors from (or appointed by) the controlling board, with three or four additional directors who have no conflicting duty of loyalty to the first corporation.

If the organization intends to operate as a subsidiary or related entity to another not-for-profit corporate entity, the bylaws of both organizations should be carefully conformed to reflect the relationship.

(3) [1.52] Election by members

The most complicated organizational challenge in membership organizations is the process of electing directors. To reduce possible future conflict, bylaws must describe the electoral process.

There are three common procedures to handle membership voting. The first involves a direct vote

of members at an annual or special meeting called for that purpose. Members who are present at a duly called meeting may vote for candidates nominated “from the floor” or by a previously set selection process. Members who do not attend do not vote, unless the bylaws provide for absentee ballots or proxies. Voting may be by show of hands or by written ballots, etc. A second method of membership voting involves the use of mail or e-mail ballots. Organizations with membership spread over a large geographic area usually utilize ballot voting to encourage maximum participation. Mail ballot voting can be organized in many different ways; the NFPCA is not restrictive. With regard to ballot voting by e-mail or other electronic communication, see §1.46 above. In both cases, the bylaws should describe the ballot process in detail, before interested parties have acquired vested rights in a process. The third method of membership voting is voting by delegation, in which the members vote for delegates who in turn serve as an electoral college to vote for directors.

#### (4) [1.53] Voting rights

As a general rule and in the absence of any specific provision in the bylaws, each director has one vote on every matter to be addressed by the board of directors. However, there may be different classes of directors with variations in voting authority. Specific officers or employees of a corporation may be ex-officio non-voting members of the board, which is often the case with charitable organizations that rely on public funding from government or private foundations. Many publicly-supported charities require that all voting directors be volunteers, so that, if the employed CEO is a director, he or she must be a nonvoting director. Restrictions on the director’s voting rights must be expressly provided in the bylaws. The law favors personal discourse among the directors. The NFPCA prohibits directors from voting by proxy; NFPCA §108.05(d) states unequivocally, “No director may act by proxy on any matter.”

#### (5) [1.54] Compensation

Compensation of directors is common for trade associations, civic leagues, and other non-charitable corporations. The NFPCA provides that reasonable compensation is permitted, unless prohibited in the articles or bylaws. NFPCA §108.05(c). For any organization that is tax-exempt under Code §501(c)(3), the term “reasonable compensation” must be considered in light of the intermediate sanctions codified at Code §4958. See discussion in Chapter 2. Charitable organizations usually do not compensate directors because of limitations imposed by most large private foundations and community trusts. As a general rule, they will have only volunteer directors, with the possible exception of a chief executive officer.

#### (6) [1.55] Terms of office

Terms of office for directors may be as long or short as the drafters desire. Under NFPCA §108.10(c), if the bylaws are silent as to the term of office, then directors’ terms expire at the next meeting for the election of directors (usually one year). On its face, the statute permits directors to have a lifetime tenure if the organization has no members to vote directors in and out and if the bylaws do not provide for term limits, but it is not wise to have a voting director or officer “for life.” In order to maintain continuity as well as to develop leadership strength, many boards allow directors to serve for up to two or three terms, thereby providing continuity to balance out new recruits. A lifetime interest in corporate voting rights may not be enforceable in a court of law. Such generous delegation of authority by the founders would likely be perceived as a gesture of self-interest. Honorary nonvoting roles awarded for past services to the corporation are not criticized herein. The authors generally recommend that terms be limited to two or three years, with a limit of two or three successive terms.

Staggered terms of office are a device that facilitates rotation of seats on the board. Under such a provision, a specified number of officers come up for election each year. For example, if a corporation has six directors, each of whom serves a three-year term of office, two directors are elected every year. Two of the initial directors have terms of one year, two of two years, and two of three years to get the cycle started. A staggered board is sometimes called a “classified” board because the rotating groups are called classes (*e.g.*, Class of 2001, 2002, 2003, etc.).

#### (7) [1.56] Removal

In an ideal world, directors would work in reasonable harmony with a common vision and set of goals. But a contentious, ego-driven, distracted, unavailable, or self-interested director can adversely affect the morale of a board and may cause effective and valuable directors to resign. NFPCA §108.35 provides for removal of directors with or without cause unless the bylaws require some type of cause to be established. This is a frequently overlooked but very important statutory provision. The bylaws should include a simple procedure to remove a director with or without cause on a majority vote of the board. A general rule in establishing this provision is that the removal process should be assigned to those who have the power to elect the director in the first place. Some drafters suggest that there should be a supermajority required for removal, so that a director cannot be removed for casual reasons.

#### (8) [1.57] Meetings

It is critical that the bylaws include provision for the calling of directors’ meetings. Unlike members’ meetings, the NFPCA does not require a board of directors to meet and gives no process by which directors can compel them to do so. It simply provides that meetings of the directors “shall be held upon such notice as the bylaws may prescribe.” NFPCA §108.25. Presumably, a court would have authority to take control of a deadlocked corporation and appoint a receiver to conduct its corporate business (starting with the removal of some or all of the directors), but this would impair the corporation’s operations, and perhaps signal the end of the organization’s life. Although there does not seem to be any reported court case involving directors refusing to convene a meeting, it is an issue that can be avoided by recognizing the importance of including a bylaw on the issue.

In most cases, the bylaws will authorize the president or chairperson of the board to call board meetings. However, there could be reasons that the designated officer may not want to do so (*e.g.*, when he or she knows that a majority of directors want to remove him or her from office or to approve a resolution to which he or she is strongly opposed). Consequently, the bylaws should authorize a specified number or percentage of the directors to call a meeting if the authorized officer is unwilling or unable to call one.

#### (a) [1.58] Quorum and manner of acting

A quorum refers to the number of directors required to be in attendance in order for an official corporate meeting to be convened and in order to take action on matters of business. Unless the bylaws provide otherwise, a simple majority of the directors then in office will typically constitute a quorum for purposes of conducting board business. NFPCA §108.15(a). The NFPCA permits bylaws to require a different proportion of the directors to be a quorum, except that a quorum cannot be less than one third of the directors then in office. *Id.* Different circumstances call for different quorum requirements. A very large board may do well with a low percentage quorum requirement, while a two-thirds requirement may be proper for a board with six or fewer directors. Certain actions, such as amending the articles or bylaws, will usually require a supermajority, while routine matters call for a simple majority. A corporation should not facilitate

a relatively small group of directors to approve important matters of business merely because meetings are difficult to attend. Telephone conferencing or unanimous written consents are valuable methods of keeping a high level of board involvement. See §1.60.

The “manner of acting” is a term describing the number of votes necessary to be cast for or against a matter at a duly convened meeting. A quorum must be in attendance for the meeting to be “duly convened,” and a majority of *that* number will carry the vote. The NFPCA provides that a majority vote is required unless the bylaws require a different proportion. Like the matter of a quorum, the manner of acting must be considered for different situations. Amending the articles or bylaws should require a larger vote, while routine matters should require a majority vote or less. The sale of corporate assets, borrowing large sums of money, or removing a director are matters that may require the vote of a supermajority.

(b) [1.59] Notice

Bylaws should specify when and how notice of meetings shall be delivered and whether the purpose of the meeting must be specified. Under the NFPCA, notice of board meetings is left to the discretion of the bylaw drafters, except in the case of a meeting being called to consider removal of a director. Such meetings must be preceded by specific written notice delivered 20 to 25 days in advance. NFPCA §108.25.

Unlike statutory requirements of written notice of members’ meetings, the bylaws may provide a less formal notice for directors’ meetings. Unless the bylaws provide otherwise, the NFPCA now empowers directors to be notified by telephone, e-mail, or facsimile. As long as all directors receive timely and effective notice of a meeting, the method of notice can vary, even for a single meeting. Some boards simply provide notice of future meetings by passing a resolution at the annual meeting for the rest of the year. However, when notice of meetings is casual or ambiguous, a meeting may be challenged by an absent director who can prove that he or she has not received notice. It is therefore good policy to require some form of affirmative acknowledgment if the corporation permits notice of meeting by telephone or email. Imagine how difficult it may be to prove in court that every director received a phone call from the secretary. In the absence of provable notice, every decision of the directors may be open to challenge unless all directors sign a consent to waive notice. Although it requires discipline, the best notice to directors is notice that is mailed a week or two before each meeting. It is good to include with the notice the agenda for the coming meeting, as well as a copy of the treasurer’s most current financial report.

If e-mail or other electronic communication is going to be used for notice of meetings, legal counsel may consider placing additional provisions in the bylaws to outline a proper procedure. For example, the bylaws can charge the secretary with the responsibility of maintaining signed consents for voting directors and other individuals entitled to receive notice. The consents will expressly authorize the corporation to send notice to the director by e-mail and include a space where the director provides his or her preferred email address. Additional measures may require directors to reply to all e-mailed notices with a simple confirmation of receipt which can be kept in the corporation’s records.

(c) [1.60] Telephonic and informal meetings

NFPCA §108.15(c) provides that boards may convene meetings by telephone unless such meetings are prohibited by the bylaws. This method of holding a meeting is especially valuable for organizations whose directors are geographically distant from each other. All directors must receive notice of the intended telephonic meeting. Not all directors must participate; a quorum is sufficient. However, all directors who choose to participate must be connected, so that each can hear all other directors at the meeting, thus

requiring a telephone conference call capability.

Some board issues do not require discussion and can be decided by an “informal action of the board” under NFPCA §108.45. A written notice of the issue, including the full text of its proposed resolution, must be sent to every director. All (*i.e.*, 100 percent) of the directors can consent by writing rather than by a meeting. This procedure cannot be used to resolve controversial issues. However, when the board has adequately discussed an issue, and its resolution is dependent on some item of information or the occurrence of a specific event, the board can adjourn its meeting and agree to finish the decision by unanimous written consent. Such consent to carry out board business by informal action requires a unanimous vote of all directors entitled to vote on a specific matter.

As of January 1, 2010, the NFPCA now permits written consents to actions without a meeting to also be transmitted electronically by directors, such as in the form of e-mail, provided the corporation’s bylaws or articles do not expressly prohibit it. Note that directors’ written consents are still required to be signed by the director and/or voting committee member even when transmitted electronically. While the use of an electronic signature is permitted, a safer course of action is for each director to physically sign the informal action and send a scanned copy of the physical signature by e-mail or facsimile.

As noted above, directors may not vote by proxy. NFPCA §108.05(d). While *members entitled to vote* may delegate a proxy to exercise their vote, the NFPCA assigns the right to vote to each director, and no voting authority may be assigned or delegated to another person.

#### *h. Committees*

##### (1) [1.61] Committees of the board with authority to act

NFPCA §108.40 authorizes the formation of committees with authority to act on the board’s behalf. The NFPCA is very specific about the composition of such committees and the level of authority that may be exercised. In addition, committee composition and authority and power should be carefully defined in the bylaws.

##### (a) [1.62] Composition

Under NFPCA §108.40(a), committees with authority to act on the board’s behalf must include at least two directors, and at least a majority of their committee membership must be directors. This means that non-directors may be committee members. Of course, the bylaws may require greater participation by board members or that committees be composed only of directors. Committee quorums, majority rule, and other structural requirements are similar to those of the board.

Appointing non-directors to serve on committees is a useful device for broadening participation in a not-for-profit’s operations. The not-for-profit may supplement the skills of its board and strengthen its governance function and board oversight by bringing in non-directors to participate in committee work. For example, it may bring in persons with financial expertise to serve on the finance committee, persons with program skills, or consumer representatives to serve on program-related committees, etc. This is also a means for a board of directors to evaluate interested persons for future board membership.

(b) [1.63] Authorization to act

The provision that committees of the board may exercise the same authority as the board without seeking board ratification of their actions means that a committee chair may legally bind the organization by, for example, authorizing the signing of an out-of-the-ordinary-course contract. If the organization does not want board committees to have this power, then it must specifically address the issue in its bylaws and monitor its use of committees. However, outsiders may rely on the apparent authority of a committee, and a bylaw may not be sufficient to protect the corporation from liability, if a committee member has entered into a contract. If a committee member orders construction or maintenance work, the entity may be liable, even if its bylaws explicitly withhold such authority and even if the committee was instructed to obtain full board approval before acting in any given instance.

There are several matters that cannot be delegated to a committee. NFPCA §108.40(c) states that a committee may not:

- (1) Adopt a plan for the distribution of the assets of the corporation, or for dissolution;**
- (2) Approve or recommend to members any act this Act requires to be approved by members, except that committees appointed by the board or otherwise authorized by the bylaws relating to the election, nomination, qualification, or credentials of directors or other committees involved in the process of electing directors may make recommendations to the members relating to electing directors;**
- (3) Fill vacancies on the board or on any of its committees;**
- (4) Elect, appoint or remove any officer or director or member of any committee, or fix the compensation of any member of a committee;**
- (5) Adopt, amend, or repeal the bylaws or the articles of incorporation;**
- (6) Adopt a plan of merger or adopt a plan of consolidation with another corporation, or authorize the sale, lease, exchange or mortgage of all or substantially all of the property or assets of the corporation; or**
- (7) Amend, alter, repeal or take action inconsistent with any resolution or action of the board of directors when the resolution or action of the board of directors provides by its terms that it shall not be amended, altered or repealed by action of a committee.**

(c) [1.64] Standing and ad hoc committees

The bylaws may designate standing committees with specific authority and responsibilities. An Executive Committee typically consists of the board officers and acts in place of the board between board meetings. Other committees (for example, personnel, program, nominations, finance, development, etc.) may be created by bylaws. The enabling bylaws may designate, by title, all or some directors and officers who will serve, who will chair, and what the specific responsibilities and reporting requirements are.

The bylaws may authorize the board to appoint ad hoc committees to serve a specific purpose. For example, a board considering the purchase of real estate might appoint an ad hoc committee composed of

a few board members, a realtor, a banker, and an attorney. The resolution authorizing the committee may further authorize it to obtain professional services, site surveys, and construction services but restrict the final approval to a full board decision. Often, a committee authorized to organize and conduct the annual convention for the membership may be authorized to sign hotel contracts and engage speakers.

(2) [1.65] “Committees” of the board without authority to act

NFPCA §108.40(d) permits the board to appoint a “commission, advisory body or other such body” that does not include the number of directors authorized to act for a board of directors on behalf of the corporation. This type of committee should not be called a “committee” but by some other name that reflects its non-authoritative status. Such a group might be called an advisory council, task force, or the like. It should have no corporate authority except to incur expenses sufficient to cover the costs of its meetings.

Advisory boards are useful when the board needs information about member concerns, about what is in the public interest, or about some technical aspect of organizational programs or services. The entity may study the subject and report to the board with recommendations, but it cannot be given authority to act independently, as if it were a board committee.

*I. [1.66] Officers*

There are several important issues regarding officers that must be addressed in the bylaws. These issues include the distinction between officers and directors, the names to be given the various officers, and their roles and relationships.

(1) [1.67] Distinction between officers and directors

Officers do not have to be directors, and vice versa. While many people think that, if a person is an officer of a corporation, then he or she must also be a director, this is not the case. Unless the bylaws provide that an officer must be a director, the entity is free to choose officers from outside its board. The bylaws should state that officers need not be directors.

(2) [1.68] Titles of positions

The NFPCA does not require that any officer be given any specific title. NFPCA §108.50, the section that establishes the authority of officers, does not refer to any specific officer other than an officer “in this Act generally referred to as the secretary [who] shall have the authority to certify the bylaws, resolutions . . . and other documents of the corporation as true and correct copies thereof.” The Act intends to leave the naming of officers to the organization itself. There are other places in the NFPCA where traditional officers such as president, vice president, treasurer, etc., are referred to, but without the implication that every corporation must designate officers in a specific way.

While the Secretary of State annual report form (see §§1.85 and 1.117) refers to the “President,” “Secretary,” and “Treasurer,” and other Secretary of State forms require, for example, that articles of amendment be executed by certain designated officers (see §§1.103 and 1.121), an organization may be nontraditional in its officer designations. (For example, if a corporation designates its principal executive officer to be the “Grand Pooh-Bah,” the Secretary of State will not object.) However, outsiders may not accept the nonstandard terminology and may require verification as to the authority of non-customarily named officers. Having to provide a certification of the role of an officer when a business contract is

negotiated becomes cumbersome, and conservatism, in order to avoid this problem, is warranted.

(3) [1.69] Roles and relationships

Depending on the needs of the organization, the roles of some traditional officers may be split. For example, the role of the president is often split among three functions — chairperson of the board, executive director of the staff, and president of the corporation. This kind of split is common in larger public charities, with the chairperson being an influential person who can attract similar people to support the organization and who is responsible for overseeing the operation of the board of directors, the executive director being employed to conduct the day-to-day operations, and the president being a voting board member who has general signature authority to bind the corporation. Other organizations may combine multiple functions in a single person, such as president and executive director.

While NFPCA §108.50(a) states that a single individual may assume more than one office if the bylaws so provide, it is good practice that the secretary of the corporation and the president be separate persons, since business contracts and documents for governmental filings often require the president's signature to be attested by the secretary.

It is common in larger organizations that the treasurer and the secretary be professionals, such as accountants or attorneys. These two officer roles require a high degree of technical proficiency but are not as significant as the president and chairperson of the board. Common forms of bylaws require that the secretary be the keeper or controller of the corporate records and the treasurer be in control of financial records. Thought should be given to the best system for maintaining these records, especially if the officers are volunteers. Certainly, these officers should have copies of relevant records, but the original copies of all important corporate records should be maintained at the principal offices of the corporation. Sometimes, legal counsel for the corporation maintains possession of the official copies of the fundamental corporate documents.

*j. [1.70] Conflicts of Interest — Directors and Officers*

There has been increasing concern about the problem of conflicts of interest of not-for-profit directors and officers. Prior to 1986, the Illinois Not for Profit Corporation Act did not mention conflicts of interest. However, Illinois courts ruled on circumstances that involved substantial conflicts of interest on the part of directors. *See, e.g., Mile-O-Mo Fishing Club, Inc. v. Noble*, 62 Ill.App.2d 50, 210 N.E.2d 12 (5th Dist. 1965). From 1943 to 1986, Illinois courts frequently opined on cases involving the fiduciary duties of trustees and disloyal actions by fiduciaries. Private inurement of charitable assets was addressed as a violation of a fiduciary's duty of loyalty, and the term "conflict of interest" generally appeared within this context. When a corporate director is aware of a personal conflict of interest, he or she had a duty to disclose any personal interest that may affect the decision of the board of directors. When there is a breach of this duty of loyalty, the courts may, under Illinois common law, presume some degree of fraud in a transaction and determine the transaction voidable unless the "dominant person" introduces evidence that a transaction was fair to the organization and should not be voided. *See, Clark v. Clark*, 398 Ill. 592; 76 N.E.2d 446 (1947).

The Charitable Trust Act, 760 ILCS 55/1, *et seq.*, was enacted in 1961 to codify this developing body of Illinois common law. That Act empowers the Attorney General to protect and enforce compliance with the law concerning the duties of fiduciaries in possession of charitable assets, giving the Attorney General power to protect charitable assets from those who abuse their power and enrich themselves at charity's

expense. *In re Estate of Tomlinson*, 65 Ill.2d 382, 359 N.E.2d 109, 3 Ill.Dec. 699 (1976); *People ex rel Scott v. George F. Harding Museum*, 58 Ill.App.3d 408, 374 N.E.2d 756, 15 Ill.Dec. 973 (1st Dist. 1978).

In 1986, the newly revised Illinois Not For Profit Corporation Act included Section 108.60 Director Conflict of Interest. In effect, Section 108.60 created a safe harbor for certain actions approved by the board of directors that would otherwise be voidable under Illinois common law due to the relevant conflict of interest of one or more of the directors. The statutory provision reversed presumptions under Illinois common law so that only a transaction unfair to the corporation is voidable. The burden of evidence is upon the person who is challenging the validity of an action. This provision is important in that it makes the resolutions of a board of voluntary directors more reliable to the business community when contracting for goods or services with a not-for-profit corporation.

Effective January 1, 2010, a new subsection (e) states that, “[t]he provisions of this Section do not apply where a director of the corporation is directly or indirectly a party to a transaction involving a grant or contribution, without consideration, by one organization to another.” It would seem that this new provision takes transactions involving grants or contributions without consideration out of the safe harbor which is the central feature of Section 108.60. In effect, the board of directors must be extra diligent when it resolves to disburse corporate assets without consideration. A conflict of interest by one or more of the directors may result in the invalidation of such corporate action if any one would challenge the transaction. In such case, under common law, the transfer of corporate assets would most likely be contrary to the best interests of the grantor corporation. The proponents of the action have the burden to show that the action was a good and proper use of the assets. Another troubling aspect of the new subsection (e) is the suggestion that transfers may go from “one organization to another”. Does this language suggest that a transfer may be made by a qualified tax-exempt organization to another less qualified organization? The NFPCA does not define the term “organization”. Surely such transfer of charitable funds to a non-qualified person or organization would be more than a voidable transaction. Perhaps the concern is obvious, but it would be good to clarify this language so that an unskilled non-profit manager would not be inclined to see this subsection as indirect permission to engage in an impermissible private benefit transaction.

Bylaws should speak to conflicts of interest between not-for-profit directors and officers and the not-for-profit corporation they serve. There is a growing trend among attorneys to include a restatement of NFPCA §108.60 in the bylaws to guide officers and directors in this matter. As discussed above, the NFPCA makes it clear that the mere existence of a conflict of interest in a corporate decision will not automatically void a contract or other transaction. However, such a conflict may invalidate a transaction if the transaction is unfair to the corporation. The key to dealing with a conflict of interest is full and timely disclosure by all interested parties and removing those parties from the decision-making process.

Conflicts of interest are of concern to the IRS as well. It would seem that the IRS’ interest is mainly directed at prohibiting inurement and/or other forms of improper private benefits. The IRS Sample Conflicts of Interest Policy (see §1.148) is useful. While the IRS policy statement is not law as to the legality of a questionable transaction, the IRS has laid a foundation to challenge nonconforming practices. This policy statement was published shortly after the intermediate sanctions provisions (Code §4958) became law. It seems likely that the IRS will treat transactions involving improper conflicts of interest as “excess benefit transactions” for purposes of imposing penalties and excise taxes. This IRS posture is described in greater detail in Chapter 2 of this handbook. In addition, since the enactment of the Sarbanes Oxley Act of 2002 (SOX) the issues of transparency and conflicts of interest have become significant at various government regulatory agencies. Although the Act does not explicitly apply to nonprofit corporations, nevertheless, many commentators suggest that the legal issues affecting accountability of publicly traded stock

corporations also affect public charities. Fiscal responsibility is increasingly important for the directors and managers of nonprofit charities. This is especially true for larger organizations such as hospitals and educational institutions. For these reasons and to make directors aware of this issue and of what their duty consists when a conflict of interest arises, the author recommends that the organization have a conflict of interest policy either included as a bylaw article or as a separate written policy identified by reference in the bylaws. Correspondingly, the Board of Directors should individually complete annual disclosure of interest written statements to promote organizational accountability and integrity. NOTE: SOX does apply to the nonprofit community in regard to the “whistle-blower” provisions and certain document retention issues.

k. [1.71] *The Three I's: Immunity, Indemnification, and Insurance*

Under the common law doctrines relating to charitable trusts, a charitable organization's assets traditionally could not be used to protect the private interests of its officers and directors. The doctrine of charitable immunity worked with this common law doctrine to protect corporate assets from attack by injured third-party plaintiffs. This doctrine did not shelter the negligent acts of officers and directors but prior to 1950, lawsuits alleging negligence on the part of a nonprofit governing board were rare. With the demise of charitable immunity during the 1960's, plaintiffs attorneys began routinely naming the directors of a negligent nonprofit corporation as additional defendants. (See previous Section 1.8). However, charitable trust law did not permit a charitable organization to expend charitable assets to protect the personal interest of officers and directors. Early in the 1970s, the Illinois legislature evaluated the emerging problems with civil liability affecting volunteer directors of charitable organizations. In 1980, the NFPCA (1943) was amended to add Sections 24(a) - (g), indemnification and insurance provisions affecting directors and officers. In 1986, the Act was further amended to provide “limited liability of directors and officers and persons who serve without compensation”, Section 108.70.

(1) [1.72] Liability (immunity) for directors and officers

The NFPCA provides limits to the liability exposure of “directors, officers and persons who serve without compensation.” NFPCA §108.70. In general, it is a good law to protect volunteers serving charitable activities, but it has gaps, and boards must cautiously evaluate how much protection it affords. *Robinson ex rel. Estate of Robinson v. LaCasa Grande Condominium Association*, 204 Ill.App.3d 853, 562 N.E.2d 678, 150 Ill.Dec. 148 (4th Dist. 1990). See also Louis S. Harrison and Eric L. Marhoun, *Protection for Unpaid Directors and Officers of Illinois Not-for-Profits: Fact or Fiction?*, 79 Ill.B.J. 172 (1991). The NFPCA protects volunteers from personal liability when vicarious liability would attach for injuries suffered by third persons as a result of the negligent acts or omissions of the organization's agents and employees. However, there are some significant limitations to this rule, as explained below. (Technically this statute does not provide “immunity” but the limited liability is often described with that word).

(a) [1.73] Corporations qualified for tax-exempt status under Code §501(c)

NFPCA §108.70 covers only corporations that are qualified for tax-exempt status under Code §501(c), which includes religious, charitable, and educational organizations as well as trade associations, civic leagues, fraternal societies, etc., but it does not cover municipal corporations or the variety of special tax-exempt organizations.

(b) [1.74] Directors, officers, and persons who serve without compensation

NFPCA §108.70 covers only directors, officers, and persons who serve without substantial

compensation. Directors who receive more than \$25,000 per year as compensation, apart from reasonable direct reimbursements, are not protected. Employed officers and members may be liable for tort injuries, just as are other employees of the corporation. The section does not specifically cover members, but they are generally protected under §107.85 as persons serving without compensation.

(c) [1.75] Individuals directly or indirectly responsible for causing an injury

NFPCA §108.70 does not cover anyone who is directly or indirectly responsible for causing an injury due to his or her willful, wanton conduct that shows a deliberate intention to cause harm or an utter indifference to or conscious disregard for the safety of others and their property. While these elements can be alleged in the plaintiff's petition even if they cannot be proved, this is where a weakness in the immunity provision lies. Directors may ultimately be immune from liability, but they still must defend themselves if they are named defendants. Legal defense costs are the greatest disbursement by insurance companies offering directors and officers coverage.

(2) [1.76] Indemnification of directors, officers, volunteers, and employees

NFPCA §108.75 allows a corporation to indemnify its directors, officers, employees, and agents against personal liability for negligent acts or omissions that injure persons or property. The indemnification language is permissive and not mandatory. Having indemnification language in the bylaws, the drafter of bylaws may choose to change the permissive "may" to the mandatory "shall," thus requiring the organization to obtain insurance to cover this liability. However, because unintended liabilities of a corporation may be created, this is a very significant matter and requires advice from legal counsel.

The indemnification language of the NFPCA may be incorporated into bylaws in two ways. The first is to incorporate by reference. Some attorneys feel it is sufficient to add a short paragraph referencing the relevant sections of the NFPCA and incorporating them into the bylaws. Many drafters simply restate NFPCA §108.75 verbatim in the bylaws. The latter procedure provides two benefits: assurance that all aspects of the law will be applicable and assurance that the board of directors will have the full language of the NFPCA indemnification clause at their fingertips to read and understand. In either case, one can include a provision that automatically incorporates subsequent amendments to relevant sections of the NFPCA.

Finally, if directors wish to take advantage of the indemnification language in the NFPCA, it should be incorporated into bylaws before a legal conflict arises. After directors have been named in a lawsuit, it may be difficult or impossible to find a sufficient number of disinterested (unconflicted) directors to vote to amend the bylaws to include an indemnification provision.

(3) [1.77] Insurance to cover indemnification

NFPCA §108.75(g) specifically permits the corporation to purchase insurance. Without directors and officers liability insurance, to underwrite a corporation's guarantee against personal liability, the indemnification provision is meaningless.

(4) [1.77A] Board Conflict Resolution

When conflicts arise concerning board members, it is often helpful to have a bylaw provision or separate written policy incorporated by reference in the bylaws providing for the orderly and effective resolution of such disputes. See § 1.148A for sample language.

### 3. [1.78] Amendments to the Articles of Incorporation and Bylaws

In the absence of language to the contrary in either the articles or the bylaws, the NFPCA gives authority to amend either document to “members entitled to vote on amendments” (§110.20) or, if there are no such members, to the directors alone (§110.15). *Harris v. Board of Directors of Community Hospital of Evanston*, 55 Ill.App.3d 392, 370 N.E.2d 1121, 13 Ill.Dec. 94 (1st Dist. 1977). If not-for-profit members have authority only to elect directors, they do not have authority to vote on amendments to the bylaws. If the drafter intends that members should have influence over future amendments, that authority must be provided for in either the articles or the bylaws.

The default authority to amend bylaws lies with the directors, who may be able to alter the voting rights of the members who are not expressly entitled to vote on amendments. In *Harris*, the corporate documents of a hospital were silent as to amending the bylaws. The court ruled that, notwithstanding the objection of members, the board of directors had the exclusive power to amend the bylaws. Following this ruling, the directors eliminated the members, and the corporation became a nonmember organization with all power vested in its board. As a general rule, the doctrine of due process of law would be available to protect vested voting rights of members. Good practice calls for this matter to be addressed in the bylaws or articles of incorporation.

The bylaws of most membership organizations do give limited authority to voting members to influence the amendment process. For example, a common provision authorizes the board of directors to consider and recommend amendments to the voting members, who in turn decide the final outcome. Usually, the notice provisions for a meeting of members to amend articles or bylaws require the exact wording of the amendment(s) to be included with the notice. Often, a supermajority vote is required to approve amendments. In some cases, a majority of all members entitled to vote is required, not just a majority of those attending a meeting.

Organizations with no members have an easier time amending bylaws. Although the NFPCA clearly authorizes a majority of the directors to amend either the articles of incorporation or the bylaws, it is good practice to have a bylaw provision that requires extraordinary procedures when amending governing documents. One may place such a provision in the articles of incorporation as well as in the bylaws.

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