Centre for Social Finance Law

SOCIAL IMPACT HUB

TEMPLATE CONSTITUTION FOR PURPOSE & PROFIT COMPANY

DISCUSSION NOTES

Important Note – Use of this Document:

These Discussion Notes been prepared by the Centre for Social Finance Law for general reference only. They do not take into account the objectives, needs or financial arrangements of any particular social enterprise, and they do not constitute legal or tax advice. They are not intended to be a comprehensive review of all relevant issues. Please take legal advice before applying anything contained in these Discussion Notes to specific issues or transactions.

These Discussion Notes are issued as at 10 September 2021.

1. MISSION LOCK

1.1 Where is the social purpose stated in the Constitution?

The social purpose is stated in Rule 2 (*for purpose and profit*).

Rule 2.1(a) sets out a general object to deliver returns to shareholders (ie for-profit) whilst having an overall positive impact on society and the environment (ie for-purpose). Rule 2.1(b) allows that general purpose to be supplemented by listing specific objects in Schedule 1. The Company is not required to have specific objects but adding objects in Schedule 1 will enable the Company's constitution to be tailored to the specific social or environmental objeictives the Company wishes to achieve.

Those two components together make up the objects of the Company, its "Purpose". Where a company sets out its objects, an act of the company is not invalid merely because it is contrary to or beyond any objects in the company's constitution[1] but the objects will help to define the interests of the company and the purposes for which the directors must act (see further on directors' duties below).

1.2 How is the social purpose locked into the Company?

The social purpose is locked into the Company by being set out as the objects of the Company in its constitution. The directors will be required to take those objects into account when seeking to act in the best interests of the Company[2]. The social purpose can only be changed or replaced by amending the constitution, and there are special protections in the constitution against adverse amendments[3].

---

1 Section 125(2) *Corporations Act 2001* (Cth)

2 See rule 2.2 and the discussion on directors duties below.

3 See paragraph 2.3 below.

1.3 **Who can amend the social purpose or other provisions of the constitution?**

The members can amend any provision in the Company's constitution by special resolution but the amendment will not have effect unless it is also approved by an ordinary resolution of the Governor Members (rule 36). This means that regardless of how much equity funding the Company has raised (and whether through ordinary or finance shares) the Governor Members have the ability to protect the Company from deviation away from its purpose.

The requirement for both a special resolution of the members as a whole and an ordinary resolution of the Governor Members sets a high threshold. The special resolution of members as a whole is required by the Corporations Act (s136). The ordinary resolution of Governor Members is an additional protective requirement that is best suited to companies with a relatively small number of Governor Members. It relies on the Governor Members to be the guardians of the Company's social purpose. Often the Governor Members will be the founders or promoters of the Company and therefore will have a well developed understanding of and commitment to the social purpose.

Where the Company has a large number of Governor Members or is evolving beyond its initial specific purposes, it may be appropriate to consider different protective mechanisms such as (for ease of administration) an ability to make minor administrative amendments without the extra approval by ordinary resolution of Governor Members, or (for enabling principled evolution) mandatory consultation with an independent impact expert.

Schedule 1 includes a paragraph giving the Board the ability to add specific objects to meet actual (and changing) needs[4]. This allows the specific functions and activities of the Company to evolve to meet changing social and environmental needs. This is also subject to a protective mechanism – the change must be approved by an ordinary resolution of Governor Members.

1.4 **Who can protect the social purpose of the Company if the directors go rogue and apply the Company's assets to their personal benefit or other purposes?**

It is the members who are in the prime position to protect the social purpose of the Company if the directors go rogue. The Governor Members have particular rights and as they are a key protective mechanism for preserving the social purpose of the Company, the constitution includes provisions that control who holds them (see the discussion on members roles and voting rights below).

As between the Company and a third party, a rogue act by the Board is not invalid merely because it is contrary to or beyond any objects in the Company's constitution (*Corporations Act* s125(2)).

However, the members can remove rogue directors and can take action against them for breach of duty.

(a) The members can remove a director by ordinary resolution (or written resolution of a majority of issued shares) (rules 4.7(a) and (b)).

(b) In addition a director can be removed by a majority of the Governor Members (rule 4.7(c)).

(c) If the Board itself will not take action against a director for breach of duty (for example, if a majority of the directors has gone rogue), any member (including a Governor Member) can apply to the Court for leave to bring the proceedings

---

[4] This is structured as a power in the directors to make a fresh provision rather than alteration of the constitution as the latter relies on the statutory power in section 136 of the Corporations Act and requires a special resolution of members.

(*Corporations Act* s237). If leave is granted, the member can apply on behalf of the Company for a wide range of remedies (*Corporations Act* s233).

There may also be other rights and remedies available depending on the particular circumstances of the rogue action. Legal advice should be sought in light of the facts at that time.

1.5 Investment and borrowing powers

The Company has the legal capacity and powers of an individual and also all the powers of a body corporate (*Corporations Act* s124). This means that it is not necessary to set out in the constitution particular powers such as the power to invest assets or to borrow. However if it is intended that the Company will act as a funder of social enterprises rather than a direct operator of a social enterprise, the key investment and capital raising powers and objectives can be set out in Schedule 1 and in rules 2 and 6.

2. ASSET LOCK

2.1 Are there asset locks?

There are no asset locks in this constitution. Unlike a charity, there is no requirement that on a winding up the surplus assets of the Company are only distributed to another charity with similar objects.

This allows the Company to pursue its financial return for members both in terms of dividend income and capital gain. This is an important "for profit" feature. It provides investors with a financial opportunity that will encourage them to fund the Company's long term growth.

2.2 Risks where there is no asset lock

There is a risk that the lack of an asset lock could open a door to deviation from the Company's purpose with members or management favouring personal gain over purpose. For example, the Company could be taken over by an investor looking to strip its assets through a winding up or similar mechanism. Similarly there could be a change of heart of existing financial investors who decide they wish to realise the value achieved by the Company and cease carrying on the mission.

2.3 Protections against asset strip and similar risks

This constitution takes the approach that the fundamental protection against asset strip and similar risks is in the choice of directors and investors.

(a) The directors have a duty to manage the business of the Company – which is the pursuit of its Purpose (rule 2.2(a)) – with reasonable care and diligence, in good faith in the best interests of the Company, and for a proper purpose (see the discussion on directors duties below).

(b) The members appoint the directors, and all appointments are subject to the approval of the Governor Members (rule 4.4). For a single director company, that director will be a Governor Director (rule 4.3). In all other cases the Governor Members will always have two directors on the Board (rule 4.3). This may not always be a majority as the Board has a maximum of 6 directors (rule 4), but it will allow the Governor Directors to contest at Board level any proposal that deviates from the Purpose.

(c) The selection and mix of members and directors is protected by provisions relating to the issue and transfer of shares. The Board has the power to issue new shares (rule 24.1) but cannot undermine the class rights of the Governor Members when doing so (rules 3.6 and 36, and *Corporations Act* s246B), and the Board has the discretion to refuse to register a transfer of shares.

(d) There is a measure of protection against a takeover that is adverse to the Purpose under rule 2.2(b) which expressly notes that, in the context of a change in control transaction, the directors are not limited to, or required to give primary consideration to, the price offered per share.

(e) In relation to other methods of asset strip, there is also the protection of rule 6.3 which restricts the sale of the main undertaking of the Company without the prior approval of a special resolution of the Governor Members. In practice this means that an investor looking to realise the capital value of the Company without the support of the Governor Members would need to wind the Company up.

(f) Rule 11.2(a) protects against excessive payments to non-Executive Directors by giving the Governing Members the ability to set a cap on their directors' remuneration. Executive Directors' remuneration is determined by their employment contract with the Company (rule 11.1). This gives the Company the flexibility to recruit at market rates.

2.4 **Alternative options**

Those protections are not failsafe. If the Company is solvent, it may be wound up voluntarily by special resolution (*Corporations Act* s491).

To strengthen the protections it would be possible to include in rule 33 on winding up an asset lock of the kind found in not-for-profit company constitutions. However, this may restrict the range of investors who would be interested in taking up equity in the Company.

Other less restrictive options could be considered, for example:

(a) giving the Governor Directors 50% of the votes at Board level on major issues such as an issue or transfer of shares resulting in a change in control, senior management remuneration, etc;

(b) adding rules dealing with the distribution of windfall gains on winding up; or

(c) (for companies with a limited number of shareholders) adding a shareholders agreement with bespoke procedures to be followed before winding up (eg expert reports, offering the business to companies with similar objects etc) and budgets agreed at shareholder level.

Any option of this kind would need to be carefully assessed for its impact on potential investors in the Company.

3. DIVIDENDS, CAPITAL DISTRIBUTIONS AND PROFIT REINVESTMENT

3.1 This constitution allows dividends to be paid according to the terms of issue of the shares (see rules 3.3 and 29.2). This follows the standard entitlements of shareholders in for profit proprietary companies and will be an important consideration for any equity investor.

3.2 Similarly the constitution does not include any restrictions on distributions of share capital in addition to the rules on reductions of capital and share buybacks in the Corporations Act (which require shareholder approval and satisfaction of other requirements).

3.3 In some social enterprise vehicles there are requirements for reinvestment of profits or restrictions on windfall gains being taken as dividends or capital distributions. It would be possible to include requirements or restrictions of this kind in rules 29 and 32 but for a "for purpose for profit" vehicle it is suggested that these issues are better addressed in the terms of issue of shares and Board distribution policies.

4. DIRECTORS' DUTIES

4.1 Will the directors be in breach of their duties if they pursue the Company's social purpose (on a for profit basis) rather than focussing solely on the financial returns to shareholders and creditors?

No, but directors should still give due regard to the Company's financial objectives and they should also be aware of how the duties apply where there is a prospect of insolvency.

The directors have a duty to act in good faith in the best interests of the corporation, and for a proper purpose (*Corporations Act* s181). This includes a duty to act in accordance with the corporation's constitution. Rule 2 is an important element in defining the interests of the Company and the proper purposes for which the directors can exercise their powers.

In determining the Company's best interests in rule 2.2, the directors have a duty to consider the objects in rule 2.1 because they are expressly identified in the constitution[5]. The directors are authorised to have regard to a range of matters that go beyond simply the interests of members, and they are not required to give priority to any particular consideration. This means that they are not required to give primacy to financial interests of shareholders in the general day to day management of the business of the Company.

Rule 2.3 provides that (in substance) where a director acts in accordance with the authorisations in rule 2.2, that will not of itself constitute a breach of duty. This is contractually binding between the directors and the members (*Corporations Act* s140) and therefore protects directors from Finance Member claims that they should have focussed only on the financial interests of members.

There are a couple of important qualifications to this.

First, the authorisations in rule 2.2 do not mean that the directors can disregard the interests of the Finance Members in receiving a dividend or other financial returns but that they are authorised to pursue those interests in the context of the opportunities and constraints of the Company's purpose.

Second, there are some requirements in the Corporations Act and general law principles that can constrain how the directors must respond. For example, a director's duty to prevent insolvent trading by the Company, and liability to compensate the Company where he or she does not do so[6], apply irrespective of the constitution. Accordingly, the financial strength of the Company should always be a consideration, and if there is a prospect of insolvency it should become a primary consideration, potentially outweighing at that time social purpose considerations.

5. DECISION MAKING

5.1 What are the board and membership requirements of the Corporations Act that apply to the Company?

The Company must have at least one shareholder (*Corporations Act* s114). It cannot have more than 50 shareholders (excluding, for that calculation, employee shareholders and equity crowdfunding shareholders – see *Corporations Act* s113).

The Company must have at least one director and that director must ordinarily reside in Australia (*Corporations Act* s201A). Only an individual who is at least 18, and who has not

---

[5] See *Corporations Act* s125(2).

[6] *Corporations Act* s588G, 588J.

been disqualified from managing corporations, may be appointed as a director of the Company (*Corporations Act* s201B).

5.2 **How are members roles and voting rights determined?**

The roles of different categories of members and their voting rights are determined by the constitution which provides for three types of members:

(a) Governor Members, whose role is (broadly) to protect the social purpose of the Company and whose shares therefore have extra voting rights to limit the scope for the Company to deviate from its social purpose (see the discussion on mission lock above);

(b) Ordinary Members, whose shares have standard voting, dividend and winding up rights; and

(c) Finance Members, whose shares have rights focussed on financial returns and may have preferential dividend rights and limited voting rights.

The rights attaching to each class of share are set out in rule 3 as supplemented by the terms of issue and, for Governor Shares, the terms set out in Schedule 2.

The concept of the Governor Shares is that they will be held by a founder or other (natural) person who is committed to the social purpose of the Company and that they will have limited financial benefit. While each Governor Share will have standard dividend and capital distribution rights, each holder will only have one share.

As the Governor Shares are a key protective mechanism for preserving the social purpose of the Company, the issue, transfer and surrender of a Governor Share needs to be regulated so that the Governor Shares do not become controlled by people who are not focussed on the social purpose of the Company. The constitution includes in Schedule 1 provision for specific rules on those issues. The default regime is that Governor Shares can only be issued or transferred in accordance with an ordinary resolution of the remaining Governor Members. This default regime can be varied to suit the specific circumstances of the Company.

5.3 **How is the board appointed and what powers does it have?**

The initial directors are appointed when the Company is incorporated (*Corporations Act* s120). Additional directors can appointed by the members (by majority vote as an ordinary resolution or in writing) or by the Board, subject to the appointment also being approved by a majority of the Governor Members (rule 4.4).

5.4 **Are there any board or other committees contemplated in the constitution?**

Rule 9 permits the delegation of Board powers to a committee but, for simplicity, the constitution does not require any committee to be established.

The Board may by resolution establish a committee where it considers it appropriate, whether to allow more focussed consideration between regular board meetings, or to draw in extra expertise or for other reasons. Committees can be tailored to the Company's objects and stage of growth. Relevant committees might include:

(a) an audit committee, to ensure detailed and robust review of the Company's accounts;

(b) a remuneration committee, to monitor executive remuneration so that it meets the Company's market needs without being excessive; and

(c) a social impact committee, to monitor and verify the achievement of the Company's social purpose.

6. ACNC

6.1 Is the Company governed by the ACNC Act?

No. The ACNC Act applies to charities and not-for-profit entities. To be eligible for registration under the ACNC Act the entity must be a not-for-profit and have only charitable purposes that are for the public benefit. The Company is not structured to qualify as a not-for-profit and its purposes are not expected to qualify as charitable purposes under the Charities Act.

6.2 Would the Constitution need to change if the Company wished to be a registered charity?

If it was intended to register the Company as a charity, the mission, dividend and winding up provisions would need to be amended to enable it to qualify. It would continue to be a proprietary company (it is not possible for a proprietary company to change to a company limited by guarantee – see *Corporations Act* s162).

There are also some provisions in the Corporations Act that do not apply to charities registered under the ACNC Act and this would result in consequential changes to the constitution (generally of an administrative nature – see *Corporations Act* s111L).

7. CAPITAL RAISING

7.1 How can the Company raise capital?

The Company has power to raise capital by way of both equity (ie shares) and debt. Debt financing can be by way of, for example, bank loans or any other form of debt finance, including structured financial instruments like social impact bonds and other forms of social investment.

As a proprietary company, the Company cannot raise equity capital by offering its shares to the public in a way that is regulated under the fundraising provisions in the Corporations Act but it can offer its shares to existing shareholders, to employees and by way of an equity crowdfunding offer (subject in that case to the equity crowdfunding rules discussed below) (*Corporations Act* s113).

The Company can also accept grants and donations (rule 2.4) but they will not be tax deductible to the donor as gifts to a deductible gift recipient (DGR).

7.2 Share capital

The constitution balances the financial and social purpose objectives of the Company by creating three classes of shares:

(a) Governor Shares, which, by their nature (as a small number of shares issued with special rights to protect the social purpose), are not a source of material share capital;

(b) Ordinary Shares, which will form the core of the Company's share capital and may also be used to raise capital by way of equity crowdfunding (if the Company complies with the equity crowdfunding rules discussed below); and

(c) Finance Shares, which are able to be issued on preferred financial terms to attract tranches of share capital as needed for the pursuit and growth of the Company's business.

The Board has power to issue shares as part of its management of the business of the Company (rule 6.1 and *Corporations Act* s124), subject to the rules regulating the issue of shares (see rule 3 and Schedules 1 and 2).

7.3 How can debt be raised?

The Board has power to borrow and seek debt financing of any kind as part of its management of the business of the Company (rule 6.1 and *Corporations Act* s124). This includes providing guarantees and security. As a proprietary company the Company cannot offer debentures to the public.

This constitution does not cap the amount of debt the Company can raise or otherwise limit the nature or scope of its debt financing.

There is a risk that in some circumstances a company may become too dependent on its debt financiers, requiring the directors, when discharging their duties, to give more weight to creditor concerns potentially to the detriment of the Company's social purpose. This risk can be managed by the Board.

However, if the Company wishes to provide extra protections against this risk, it would be possible to include additional protective provisions in the constitution, for example, a requirement that the Board does not enter into any debt financing arrangement with a liability of more than a specified dollar amount without the approval of an ordinary resolution of Governor Members.

8. EQUITY CROWDFUNDING

8.1 Does the constitution allow the Company to raise capital by crowdfunding?

Yes, it is possible for the Company to raise equity by crowdfunding under this constitution provided it compies with the crowd-sourced funding requirements in Part 6D.3A of the Corporations Act.

8.2 What are the Corporations Act requirements for equity crowdfunding?

Part 6D.3A of the Corporations Act sets out a legislative framework under which eligible companies can make eligible offers of their shares, via an intermediary crowd-sourced funding (**CSF**) service, using a prescribed form of offer document. The intermediaries are required to hold an Australian financial services licence (AFSL) with an authorisation to provide a crowd-funding service. The aim of the CSF regime is to reduce the regulatory requirements for public fundraising while maintaining appropriate investor protection measures.

This constitution allows the Company to be set up in a way that will enable it to be an "eligible company" for the CSF regime, and to make an "eligible CSF offer", although it also includes some flexibilities that are outside the regime (eg rule 4.1 allows single director companies).

8.3 What is an eligible company for the CSF regime?

Some of the key requirements for the Company to be an "eligible company" for the CSF regime are that it:

(a) has at least two directors (s 738H(1)(a));

(b) has its principal place of business in Australia (s 738H(1)(b);

(c) has a majority of its Directors (excluding alternate directors) ordinarily residing in Australia (s 738H(1)(c));

(d) does not exceed the assets and annual revenue caps of $25 million (including the assets and revenue of its related parties) (s 738H(1)(d));

(e) is not listed on a financial market in Australia or overseas (including its related parties) (s 738H(1)(e)); and

(f) does not have a substantial purpose of investing in other companies, entites or schemes (including its related parties) (s 738H(1)(f)).

8.4 **What is an eligible CSF offer?**

Some of the key requirements for the offer of shares to be an "eligible CSF offer" are that it:

(a) must be an offer for the issue of fully-paid ordinary shares;

(b) must not be used to raise funds to invest in other companies, entities or schemes, or for loans to related parties (other than wholly-owned subsidiaries); and

(c) must comply with the issuer cap (ie: offers to raise no more than $5 million in any 12-month period).

8.5 **Other requirements**

There are a number of other requirements relating to CSF offers. Separate legal advice should be sought before the Company undertakes any equity crowdfunding.

9. B CORP CERTIFICATION

9.1 **Does this constitution enable the Company to be certified as a B Corp?**

The legal structure of the Company has been designed to be consistent with the legal requirements for certification as a B Corp in Australia. The legal structure is only one of the factors considered by B Lab Australia and New Zealand when assessing whether a social enterprise qualifies for certification as a B Corp.

9.2 **What are the legal requirements for B Corp certification in Australia?**

The legal requirement for B Corp certification in Australia is a purpose clause and a stakeholder clause in the form prescribed by B Lab Australia and New Zealand[7].

These clauses have been included in rules 2.1 and 2.2 of the constitution.

---

[7] https://www.bcorporation.com.au/legal-requirement