



FOUNDATIONS

The Constitution as Contract: What It Can and Can't Do

Why treating your constitution as a legal formality is the first governance mistake most boards make

Boards talk about their constitution as though it were a policy document, something to be updated when convenient and interpreted generously when inconvenient. It is neither. Under the Corporations Act 2001 (Cth), a company's constitution has the effect of a contract, and that single legal fact changes what your board can and cannot do with it far more than most boards realise.

This matters because a contract is not a guideline. It cannot be quietly reinterpreted in a board meeting because the original wording has become inconvenient. It cannot be overridden by a policy, a by-law, or a resolution that conflicts with it. And critically, it does not always give members the remedies people assume it does when it is breached. Understanding the constitution as a binding contract, not a governance suggestion, is the foundation everything else in this series builds on. For a CLG, section 140 of the Corporations Act makes the constitution a statutory contract. For an incorporated association, the state or territory Act sets out how the constitution or rules bind the association and its members, so check the wording of your own Act.

Which rules apply to your association?

The law depends on how your association is set up. A **company limited by guarantee** follows the Corporations Act 2001 (Cth) and its constitution. An **incorporated association** follows its state or territory associations Act and its rules. A **registered charity** also follows the ACNC Act and the ACNC Governance Standards, and some Corporations Act rules are replaced for charities that are companies. Check your own governing documents, and get advice before decisions with legal consequences.

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The Statutory Contract, Explained

Section 140 of the Corporations Act 2001 (Cth) provides that a company's constitution has effect as a contract between the company and each member, between the company and each director and company secretary, and between each member and every other member. This is often called the statutory contract, and it is an unusual legal creature. Ordinary contracts are formed by parties negotiating and agreeing to terms. The statutory contract is different: a new member becomes bound to the constitution simply by joining, without ever negotiating a word of it.

The practical result is that your constitution binds people who had no hand in writing it, and who may never have read it closely. That is why the drafting quality matters so much. A poorly worded clause does not just create ambiguity for the board interpreting it internally. It creates an enforceable, if imperfect, legal obligation on every member and director who joins the organisation afterwards.

What The Contract Does Not Do

This is the part most boards get wrong, often to their surprise when a dispute actually reaches a lawyer. The statutory contract only binds people in their capacity as members, directors, or company secretaries. It does not extend to rights or obligations someone holds in a different capacity entirely.

The foundational case on this point, still cited in Australian courts today, is the English decision in *Hickman v Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch 881. A related and equally instructive case is *Eley v Positive Government Security Life Assurance Co*, in which a solicitor who drafted his own company's constitution, and inserted a clause naming himself permanent solicitor, tried to enforce that clause after being dismissed. He failed. The court held that the constitution could not give him enforceable rights in his capacity as a solicitor, only in his capacity as a member. The lesson generalises well beyond solicitors: a constitution cannot be used to lock in someone's employment, a consultancy arrangement, or a personal entitlement dressed up as a governance clause. If your constitution contains provisions that read more like an employment contract or a personal arrangement than a governance rule, they may not be enforceable as part of the statutory contract at all.

The remedies available for a breach are narrower than most people expect from something described as a contract. Australian courts have expressed real doubt about whether damages are available for a breach of the statutory contract in the way they would be for an ordinary commercial contract. The more typical remedies are a declaration or an injunction, orders that clarify rights or stop conduct, rather than compensation for loss. CLG members may also seek relief under the Corporations Act oppression provisions, and incorporated association members should first use the grievance procedure in the rules and the remedies in their state Act. Boards and members alike should understand this before assuming a constitutional breach automatically means a payout is available. If a member alleges a breach, check the dispute resolution clause and get legal advice before the board responds.

Why This Should Change How Your Board Drafts

Once a board absorbs that the constitution operates as a contract, several drafting habits should change.

- Keep the constitution to matters that need contractual force and member-level protection: objects, membership classes, voting rights, board composition, and the core mechanics of general meetings.
- Push operational detail into by-laws or policies instead, provided the constitution authorises the board to make by-laws and they stay consistent with it. A constitution cluttered with day-to-day procedure is harder to amend, harder to interpret consistently, and creates more surface area for a clause to be challenged as unenforceable.
- Never use the constitution to lock in an individual's personal arrangement, a consulting fee, a permanent role, a guaranteed position, dressed as a governance clause. *Eley* is over a century old and the principle has never been overturned.
- Assume every clause will eventually be read literally by someone with an incentive to do so. The statutory contract does not care what the board meant. It cares what the words say.

The right structure is the one that survives a literal reading by someone who disagrees with you, not the one that sounded right in the room when it was drafted.

A Drafting Discipline, Not A Legal Formality

None of this requires every board to become expert in company law. It requires a specific discipline: before any clause goes into the constitution rather than a by-law or policy, ask whether it is a matter of member rights and organisational structure, or whether it is procedural detail that has drifted upward because nobody questioned where it belonged. Ask whether the clause could be read, by someone hostile to the organisation's interests, in a way the board never intended. And ask whether the clause is trying to do something a constitution legally cannot do, create a personal entitlement outside the member relationship, however well intentioned the original drafter was.

A constitution treated with this level of care becomes what it is meant to be: a reliable contract that protects the organisation and its members precisely because everyone understands its legal weight. A constitution treated as a loose governance document, amended casually and drafted without this discipline, remains a contract regardless, just one nobody fully understands until it is tested.

This is one of the practical governance topics built into our Board Director course, alongside the papers, tools and frameworks that turn the principle into your board's actual practice. [Explore the course](#)

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BOARDROOM ACTION WORKSHEET

The Constitution as Contract: What It Can and Can't Do

Turn the resource into evidence, a decision and an accountable next step. Keep the completed record in your association's approved board records system.

1 What is the issue or decision?

State the governance question in one clear sentence.

2 What evidence do we already have?

Record the facts, source documents and stakeholder evidence available now.

3 What evidence is still needed?

Identify the legal, regulatory, financial, member or operational information still required.

4 What is the agreed next action?

Capture the owner, timeframe and how the matter will return to the board.

Action owner	Review date	Board decision or resolution

General education, not legal, financial, tax, clinical or governance advice. Confirm specifics at the relevant primary source or with your own qualified adviser. Nexus Leadership is operated by Lipstick Consulting Pty Ltd · ABN 15 619 120 482.

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