Submission to the

ACT Gambling and Racing Commission's

Review of the Governance Provisions

in the

Gaming Machine Act 2004

Lodged on behalf of the members of ClubsACT

June 2010

1. Executive Summary

The Issues Paper has not established a compelling reason or a sound basis for amending the *Gaming Machine Act 2004* (GMA) as proposed.

The Commission has not identified any instance where a breach of ACT or federal law has occurred. Nor has the Commission identified any instance where a failure of governance has occurred at any club. The only instance put forward by the Commission, rather than supporting a need for change, reinforces the view that club directors are acting appropriately and existing law is sufficient and effective.

It is important to remember that virtually every club commenced life with a dedicated group of volunteers working long and hard to create a base and support mechanisms for some community, cultural or sporting activity. The original ethos, goals and objectives of those founders are more than often perpetuated through an "associated organisation".

The ability of clubs to have directors appointed by their associated organisations acts as a strong safeguard against a takeover by interests that do not align with the club's. This is the very reason why provisions for associated organisations were incorporated into the GMA in the first place

Removing these provisions would leave clubs vulnerable. Even though measures might also be introduced that would make such a takeover difficult, the associated organisations provisions **guarantee** a hostile takeover cannot occur.

The primary objectives of a club can only be protected by, and only by, the <u>dual</u> operation its constitution and the solid representation on its board of directors of those that identify with its objectives.

There are sixty licencees in the ACT, and the industry is not aware of, nor has the Commission identified in its Issues Paper, any actual concerns of governance within these clubs. There is much comment in the Paper about potential governance issues, but the club industry in the ACT has been operating for a long time and in a highly professional manner involving a high level of corporate governance.

Indeed, the outcome of the Commission's review into the circumstances surrounding the recently proposed sale of an ACT-club group, which prompted this Issues Paper, demonstrated that good governance not only prevailed but was exercised by the club's directors at every point during that process.

The proposed amendments to the GMA would have a range of negative and unintended consequences on industry including an ultimate reduction in the ability of clubs to be effectively governed.

While industry does not support amending the GMA as proposed, there are a number of measures that can be taken that would enhance governance without the negative impacts changing the legislation would involve. Ensuring that all directors are aware of their obligations under state and federal law is a sensible and appropriate step to take, as an example.

Fundamentally, there are times when a regulatory response is required to address a market or legislative failure. This is not one of those times as the Issues Paper has not demonstrated that such a failure exists. Again, the only instance raised in the Issues Paper suggests that even when there is a potential conflict between a club and its associated organisation, the club's directors acted according to the law.

The fact that a potential conflict arose does not represent a justification for removing the only effective method clubs have for protecting their core objectives.

2. Background

Following the release of the report into the proposed sale of the Canberra Labor Club Ltd, the Minister for Racing and Gaming requested the Gambling and Racing Commission (GRC) to review the provisions of the *Gaming Machine Act 2004* relating to the governance of clubs.

Specifically, the Minister requested that the review should cover, but not necessarily be limited to:

- Whether the Commission should have powers to require changes to a licensee's Memorandum and Articles of Association where they conflict (or potentially conflict) with the GMA;
- Clarifying the relationship between clubs and their associated organisations in terms of the rights, powers and obligations of the associated organisations; and
- The operation of the club control aspects of the GMA in relation to relevant aspects of the Corporations Law (C'th)

The Commission decided to also examine a number of provisions within the GMA that ensure clubs are established and operated for the benefit of members generally and not for commercial or private gain.

Several options were canvassed in the Issues Paper ranging from maintaining the status quo to amending the GMA by removing any reference to 'associated organisations', thereby removing the ability of clubs to have any of their directors appointed by the associated entity.

As the GRC's Issues Paper states, "An alternative approach to club governance would be to amend the GMA to require clubs to have truly independent boards appointed by the voting membership…"

3. Role of the Membership and Voting Rights

The Issues Paper states in section 2.4.1 that the membership of a club is the 'reason that a club exists ie to provide benefits to those that join so they can enjoy or achieve their common purpose'.

While this is ostensibly correct, it ignores the very important role associated organisations play in the life of clubs. While clubs are there to serve their members, the club also exists to pursue community, cultural or sporting objectives, which manifest in their associated organisations.

Many people join clubs with the expectation that they will not participate in the governance of that club, and merely wish to utilise the club's social facilities. At the same time, it would be fair to say that regular members still often expect their opinions to be heard in relation to the club's facilities and service levels.

Certainly many members have little time or inclination to actually assume responsibility for club management and wider governance. Many, however, identify with the long-term objectives of the particular club. This is often a key factor in choosing between clubs to join and patronise.

The relevant point is that clubs do exist to serve their members but a parallel objective is to serve the goals and objectives that gave rise to the club in the first instance, which are reflected by the associated organisation.

The fundamental question is whether or not good governance is served by removing the ability of associated entities to appoint directors to club boards.

4. Club Governance Risks

The question of risk is at the heart of the issue.

According to the GRC, the ability of associated organisations to appoint directors to club boards gives rise to governance risks as a result of directors

being put under pressure by the associated organisation to act in a way that may not be in the best interest of the club.

Such a situation is most unlikely to occur as associated organisations must be established under the same organisation principles as the club itself. As section 2.4.2 of the GRC Issues Paper states:

> "To be approved as an associated organisation the organisation must be associated with the club and the Commission must be satisfied that its approval would help the club to achieve its eligible objects"

So to be approved as an associated organisation, that entity must share the objectives of the club to which it is associated.

In the unlikely event of a conflict between the club and the associated organisation, the clear overriding obligation on a club director is to act in the best interests of that club and no other organisation. If directors fail to meet this obligation, then they are in breach of federal corporations law, and are personally liable for the consequences of that breach.

Even in the case of the proposed sale of the Canberra Labor Club Group Ltd, the event which prompted the Commission's review, the relevant directors were found to have acted properly and no breach of federal or state law was found to have occurred. Indeed, the directors were found to have met their obligations under corporations law by acting in the best interests of their members.

The Issues Paper has not established a clear nor compelling need to amend the legislation because if anything, recent events have demonstrated that directors do indeed fulfill their obligations under commonwealth and ACT Law even in the context of a potential conflict between the club and an associated organisation.

Far from highlighting a flaw, the circumstances surrounding the proposed sale reinforce the fact that existing law is sufficient and no change to the GMA is required.

5. Federal and ACT Law

Section 3.1 of the Issues Paper states:

> "The governance provisions contained in the GMA and those in corporations law should be complementary and work together to ensure

> the appropriate operation and control of club corporations. It is felt by the Commission that some of the GMA governance provisions as currently drafted do not enhance or encourage the achievement of some of the governance goals that are being sought by corporations law."

The existence of associated organisations in the GMA does not represent a conflict with federal law and the GRC has not established that the GMA does not encourage or enhance governance goals as enshrined in corporations law.

Further, regardless of what the Commission 'feels', it is very clear that club directors do not feel encouraged by the GMA to act in a manner which may conflict with the Corporations Act as was borne out during events which prompted the governance review.

There are numerous instances where ACT and federal law require different, but not competing obligations, and the primacy of federal law is well understood. The mere existence of different obligations in law does not represent a justification for amendments to that law.

6. Role of the Gaming Regulator

The Issues Paper notes that the GRC has "little power" to influence club governance other than to undertake disciplinary action or prosecution for specific breaches of the GMA. This is an entirely appropriate degree of power for a regulator to have. There is no demonstrable need for the GRC to have powers that would effectively replicate or overlap with those already applying, effectively, under federal legislation.

Further, Section 3.4 of the Issues Paper states:

> "It should be noted that responsibility for compliance in relation to corporations law remains with the Australian Securities and Investments Commission and corporations law itself is not part of this review."

Corporate governance compliance is well covered by the Corporations Act, and any attempt by the Commission to try to enhance this would potentially lead to additional conflict and confusion by directors.

7. Possible Approaches to Governance Provisions

The following are specific comments in response to the options put forward in the GRC Issues Paper.

7.1 Status quo

This option essentially involves relying on the existing provisions of corporations law to ensure club governance is transparent and effective.

The Issues Paper notes that the obligations under corporations law do not apply to incorporated associations and 14 of the current 60 club licencees fall into that category. It is not currently a requirement that club licences are corporations under the Corporations Act.

As has been demonstrated, the primacy of corporations law is well understood within the industry and any attempts to expand upon or qualify federal law should be avoided.

Industry supports taking necessary and effective steps to ensure governance remains at a high standard and has suggested a number of changes in this document.

7.2 Amend the Governance Provisions - *Gaming Machine Act 2004*

This option involves amending the GMA to require clubs to elect all of their directors with every club member afforded equal rights to vote for directors. The Issues Paper notes that some clubs may be concerned that this option would put the clubs core objects at risk of change if enough votes were cast for directors with alternative priorities.

The Paper proffers two options it believes may protect a club from being taken over by a different interest group. It has also verbally flagged a third.

"For example, the GMA could:"

- "prohibit changes to the core objects unless they were agreed by a majority of voting members at two or three successive AGMs; or"

In every club in the ACT organisations and individuals have invested money and time in developing buildings and facilities which promote the objects to which that club has subscribed. In some instances this has been the case for over forty years. It would seem unreasonable (to say the least) if the Government were to create legislation which specifically allowed this investment to be taken away in just a couple of years.

- "provide for a class of objects (such as core objects) that once a club is established could not be changed (except after a transfer of licence). Secondary or lower order objects could be changed by the membership through changes to the Memorandum or Articles of Association."

Even if a club's core objects were attached to its licence, it still does not stop an alternative interest-group from getting control of the board. Because every club's constitution allows for support to also be made to organisations which don't in fact qualify as core objects, the incentive is still there for a group to gain enormous amounts of funding via the club's secondary objects.

- The Commission has also verbally suggested that the Government could amend the GMA and prescribe ratios of donations to core and non-core beneficiaries in an effort to ameliorate the deficiencies of this second option above.

Club boards are by their nature a collection of people who are regularly required to make decisions about how a club's surpluses are disbursed. They do this taking into account the knowledge they've accumulated during their life, as well as assessing the economic environment for potential recipients at a given point in time. To prescribe how much will go to one type of charity/organisation over another is destined to provide poor outcomes.

For example, if a fire were to again devastate an area in Canberra, a club may be restricted to giving less than (say) 50% of its annual grants to assisting the victims, when in fact the individuals on the board may deem that at this point in time, it would be more appropriate to offer further assistance. Boards are the appropriate vehicle to make all decisions about a club's direction.

Changes to a company's constitution are again covered by the Corporations Act, and the Government should not attempt to reinvent the wheel by trying to over-rule or enhance the existing Commonwealth legislation.

While there would of course be some common provisions, it would be somewhat naïve to expect that a standard constitution could be crafted to operate to protect the primary aims of all clubs. A common constitution would allow an opportunity for those interested in charting an entirely new course for a club to exploit the inevitable weaknesses of that common constitution.

It is important to remember that we are not here necessarily talking about some form of malicious coup, but merely the possibility that a board, formed of people of goodwill, taking a radically different view of priorities than was intended at the formation of the club.

The essential point of difference between the status quo and the suggestions put forward is the inversion of control. The current system allows for 'ex-ante' security over fundamental objectives. Any structure that allows for the possible election of a hostile group leaves a club with 'ex-post' security, dependent on rear-guard action against major decisions and commitments that may be difficult or impossible to reverse.

The Commission notes that the NSW Independent Pricing and Regulatory Tribunal (IPART), as part of its 2008 review of the Registered Clubs Industry in NSW, considered that clubs should be encouraged to remove restrictions on board membership and voting eligibility from their constitutions.

The NSW IPART recommendations referred to in the Paper were never adopted by the NSW Government because they were not going to achieve the desired outcome. The "core features" concept still would not protect clubs from a hostile takeover, and that is why these recommendations were not adopted in NSW.

7.3 Proposed New Regulatory Powers to Require Changes to Constitutions

Allowing the Commission to effectively change any club's constitution would provide it with an extraordinary amount of power. The examples may be noble, but it would leave open the possibility of people determining outcomes that should be made by a club's board and its members.

If a club allows (to use the Paper's example) "non-members that weren't signed in and accompanied by a member to play gaming machines", then if this does not comply with the GMA, that club should be breached regardless of what its constitution says. All clubs would be aware that where a conflict arises between a club's constitution and any legislation, then the legislation prevails.

The Commission has not set out the reasons why it should have the power to compulsorily require changes to a licensee's constitution nor has it cited instances where an existing club's constitution is in conflict with the current GMA.

8. Risks of Taking Action

The Issues Paper has not provided any information on the risks of amending the legislation as proposed and the unintended consequences they would have on

the industry. It is important these consequences are given some focus in the GRC's work.

A logical outcome from the proposed changes to the nomination/election of directors is that boards will change more often. With this change there would also be more frequent changes of management and staff. As a result, there would be a reduction of personnel (both directors and staff) who are skilled in club compliance. These skills and knowledge are built up over numerous years. It would not only be a shame to see these skills diluted but it would lead to greater effort being required to ensure compliance in such an important aspect of our industry

Clubs regularly deal with banks which are conscious of the extraordinary covenants that are already being imposed on the industry. To add another layer of uncertainty in the ACT represents a real and substantial risk to the club industry.

The Commission also may not be aware that when clubs apply for loans, there is significant emphasis by the banks on the structure, stability and ability of the board and management. If a bank thinks there is likelihood a board may change its composition or direction, they flag that club as being a higher risk, which means the cost of finance increases or the loan application is simply rejected.

Under the Council of Australian Government's (COAG) commitment to regulatory reform, to which the ACT is a signatory, the benefits from each new regulation must not be offset by unduly high compliance and implementation costs or restrictions on competition.

The changes proposed would not meet the standard laid down by COAG.

9. Recommended Actions

While ClubsACT does not support the changes proposed by the GRC, there are measures which can and should be taken which would enhance club governance without the unintended consequences the proposed changes would involve.

Firstly, if the aim of the Commission and the Government is to improve corporate governance in the club industry in the ACT, then a useful step would be to require all licencees, as well as all associated entities, to be registered as Companies under the Corporations Act 2001.

This would ensure that all directors of all clubs in the ACT fall under the provisions of the Corporations Act.

Secondly, it should be incumbent upon clubs to ensure their directors are aware of their obligations under corporations law and the primacy of that law in relation to certain provisions within the GMA. The Commission may investigate the option of requiring directors to formally acknowledge to the Commission that they are aware of their responsibilities under state and federal legislation.

At the recent Clubs ACT seminar the issue of qualifications and skill sets that may be required of club directors was canvassed. Care should be taken to avoid being overly restrictive in this area.

An optimum board is a collection of complementary knowledge and skills, as opposed to a collection similarly qualified individuals. Clubs should be afforded the opportunity to gather the widest set of skills that is on offer. It is the case that, from time to time, even the largest of clubs sometimes find it difficult to attract the best talent. Restrictive prerequisites may well have the opposite effect than that intended.

It would seem reasonable that clubs should be required to notify the Commission of board appointments and that the Commission should, in turn, contact the individuals and advise them of the need for them to apprise themselves of their obligations and responsibilities.

ClubsACT also acknowledges its role in encouraging its members to adhere to principles of good governance in ensuring their board members make themselves aware of their obligations.

10. Conclusion

It needs to be remembered that the Gambling and Racing Commission was asked by the Minister to clarify the relationship between clubs and their associated organisations. The GRC has not done this.

Further, for the GRC to respond to that term of reference by recommending that associated organisations be removed from the GMA is an overreaction to a perceived, rather than real, problem. Such a move would have real and substantial impacts on the industry for very little, if any, gain.

There is a clear inference in the Issues Paper that appointing rather than voting for directors automatically equates to less or less effective governance when all evidence suggests otherwise. Allowing associated organisations the power to

appoint directors not only ensures the club stays true to its core objectives but protects the club against those core objectives being hijacked.

Section 4.2 in the Issues Paper makes reference to clubs having "truly independent boards" if all directors are elected as opposed to being appointed. The use of the term 'independent' is curious.
It is in fact reflective of a very simplistic view of how things operate. On the other hand the GRC recognizes, in its discussion paper that many club members do not have the time or inclination to be directly involved in club governance. That practical reality needs to be kept in mind when making assumptions relating to the nature of boards that might emerge.

Clubs have boards made up of directors who are committed to the objectives of the club. The same principle underpins the ability of associated organisations to directly appoint directors so that rather than being 'independent' they are also committed to the objectives of the club and protect against those objectives being altered.

Fundamentally, the Issues Paper has not demonstrated a clear nor compelling need to amend the legislation. Recent events reinforce the fact that if directors understand their obligations under law, they will act in accordance with those obligations.

To that end, ensuring all directors understand their obligations, whether they be elected or appointed, is the more appropriate and effective objective to ensure governance in Canberra's clubs remains as at a high standard.

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