

Review of the Governance Provisions of the *Gaming Machine Act 2004*

DRAFT

Final Report

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Executive Summary

This report on the review of the *Gaming Machine Act 2004* (GMA) examines and makes recommendations in relation to the policy issues concerning the governance of clubs in the ACT. Where appropriate it includes discussion on issues or comments that were raised in responses to the Commission's Issues Paper that was circulated as part of the review process.

This report does not cover minor or technical issues or changes in drafting policy that will be addressed at the time that any new legislation is drafted.

Scope of the Review

The review is focused on the governance of clubs in the ACT and in particular the provisions relating to governance in the primary legislation in this area, the GMA. The Commission has fulfilled the Minister for Gaming and Racing's request to cover, but not be limited to, a number of specific governance issues and these are set out in the introduction to this report.

The role and powers of associated organisations

The GMA currently gives associated organisations the power to appoint and remove the directors of a club. It is possible that a club and its associated organisation may experience a divergence of direction or a conflict over a specific matter. In this situation appointed directors, and in particular those that can be removed by an associated organisation, may experience pressure to act in a way that is not in the club's best interests. That this situation may arise does not amount to a systemic failure and the Commission considers that wholesale change to the role of associated organisations is unwarranted.

However, it is the Commission's view that it is appropriate to limit some of the powers of associated organisations. This is necessary to mitigate the risks arising from potential conflicts of interest between clubs and their associated organisations, including the ability of associated organisations to remove directors from a club and the maximum proportion of directors that they can appoint.

Obligations of club directors

It is a key duty of a director to act in the best interests of their organisation. This is codified in corporations law and is the primary means by which directors are held to account. The responsibility for enforcement of corporations law lies with the Australian Securities and Investments Commission (ASIC) which has a range of priorities nationally and internationally. There is a risk that the kind of issues which may occur at club level in the ACT, although potential breaches, may not warrant the application of the resources required to investigate and take enforcement action. Given the importance of "best interests" provisions as a key mechanism for holding directors to account, the Commission is of the view that further consideration should be given to introducing such a provision into the GMA.

Powers of the Commission relating to conflicting constitutions

Currently the Commission has no power to require that club constitutions which conflict with gaming laws be amended to resolve this conflict. Given the significance of a club's constitution as a key governing document, if a club's constitution conflicts with gaming laws the possibility of non-compliance and resultant disciplinary action increases. Clubs have a responsibility to be compliant with applicable legislation. The Commission is of the view that clubs should not have provisions that allow for unlawful activity in their constitutions and that a mechanism for ensuring conflicting provisions are removed is warranted. The Commission therefore considers that it should have the specific power to be able to direct a club to amend its constitution where it conflicts with a gaming law.

Powers relating to associated organisations

Associated organisations have an important role in the club industry because they may appoint the majority of directors on a club's board. The Commission currently has no power to monitor these organisations beyond the initial approval process. To approve a potential associated organisation, the Commission must be confident that the relationship is appropriate and a benefit to the club. However, it is reasonable to expect that organisations will change, perhaps significantly, over time. Because the Commission has no powers to monitor associated organisations, it is unable to reliably determine whether an associated organisation continues to be a benefit to a club as contemplated by the legislation.

Given the dominant role that some associated organisations have in the governance of clubs, the Commission considers that it is appropriate for it to have powers allowing it to monitor these organisations, such as obtaining financial statements or minutes of meetings for the purpose of compliance with the GMA.

Democratic election processes

As not-for-profit community organisations that receive significant concessions and privileges from different levels of government, clubs have a responsibility to employ systems of governance that promote transparency and accountability. However, a number of club's governance systems are clearly out of step with accepted good corporate governance principles. In remedying this situation, the Commission does not consider a legislative 'one size fits all' approach is appropriate at this point in time. Instead, the Commission recognises that the opportunity exists for the ACT club industry to address and facilitate this issue by demonstrating its commitment to generally improving its current control arrangements. This process should be monitored by Government with a view that if some general improvement has not been achieved in the industry at some future date to be determined then legislative encouragement should be considered.

Other regulatory issues

A number of provisions in the GMA relating to club governance in general were also considered as part of this review. Several relatively minor amendments to existing sections have been identified to enhance or clarify the operations of these provisions and to remove those requirements that are problematic from a regulatory point of view and have minimal benefits.

Recommendations

Recommendation 1

The Commission recommends that the GMA be amended to:

- ensure associated organisations do not have the power to remove directors; and
- provide for voting members to elect at least 25% of board directors.

Recommendation 2

The Commission recommends that the GMA be amended to:

- require directors to discharge their powers and duties in the best interests of the club and for a proper purpose consistent with corporations law.

Recommendation 3

The Commission recommends that the GMA be amended to:

- provide the Commission with the power to direct a club to amend their constitution where a conflict exists between a provision in the constitution and a gaming law, or where provisions grant a power which if exercised would constitute a conflict; and
- require, as a condition of a gaming machine licence, that a club's constitution include a provision that enables the constitution to be amended without a vote by members where the club has been so directed by the Commission.

Recommendation 4

The Commission recommends that the GMA be amended to provide the Commission with powers to:

- investigate the operations of an associated organisation and request relevant documents or information (for example financial statements and board minutes) where there are reasonable concerns that the associated organisation has changed its objects, is no longer assisting the club to meet its eligible objects or that the relationship is impacting detrimentally on the club's governance; and
- suspend or revoke the approval of an associated organisation (subject to appropriate review mechanisms) if it no longer meets the requirements of the GMA.

Recommendation 5

The Commission recommends that the Minister write to ClubsACT requesting that the ClubsACT Code of Governance be reviewed and updated to include "best practice" provisions to improve club accountability and transparency to their members. The Minister could require the Commission to monitor the progress of the review and the application of the results and provide advice back to the Minister in due course whether legislative reform is required in this area.

Recommendation 6

The Commission recommends that amendments to sections 14(1)(a), 53(4)(a), 53(4)(b), 54 and 55(d) of the GMA be undertaken as outlined in this review report.

1. Introduction

The Gambling and Racing Control Act 1999 provides for the Gambling and Racing Commission (the Commission) to review the ACT's gaming laws as part of its functions. In reviewing such legislation, subsection 8(1) of the Gambling and Racing Control Act 1999 requires the Commission to consult the community.

On 2 March 2010 the Minister for Gaming and Racing requested that the Commission review the provisions in the Gaming Machine Act 2004 (the GMA) relating to the governance of clubs. 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).

In addition to reviewing the areas outlined above, the Commission has examined other governance provisions in the GMA as part of this review.

1.1 Conduct of the review

The Commission was tasked to review the efficacy and appropriateness of the governance provisions for clubs in the GMA. The review also took into account the ACT Government's commitments under the Council of Australian Governments to regulatory reform. These commitments recognise that effective regulation is essential to ensure markets operate efficiently and fairly and to protect consumers. However, the benefits from each regulation must not be offset by unduly high compliance and implementation costs or restrictions on competition.

The review focused on the relevant policy issues concerning the governance of clubs in the ACT. This report on the review outcomes concentrates on these policy issues and does not cover minor or technical changes in drafting policy that will be addressed at the time that any new legislation is drafted.

1.2 Consultation process

There were two stages of consultation as part of this review. During the first stage the Commission called for submissions in response to an Issues Paper that was forwarded directly to stakeholders and was advertised in *The Canberra Times* as well as being made available on the Commission's website. In addition, the Commission participated in an industry seminar on the review facilitated by ClubsACT.

At the conclusion of the first stage of public consultation the Commission had received nine submissions from industry and one from an associated organisation.

Following its analysis of submissions and based on its research of the issues the Commission developed a draft report that outlined its conclusions and draft recommendations.

The second stage of public consultation involved the Commission's draft report (including recommendations) being circulated for comment.

[To be completed after second stage]

2. Background

2.1 Clubs in the ACT

Clubs, whether licensed or unlicensed, are an association of people with a common interest. A club is a not-for-profit organisation focused on providing facilities for its members. Clubs operate as mutual entities where members contribute to a common fund created and controlled by them for a common purpose.

Clubs are important in the lives of many people and can provide social capital in the community. Unlicensed clubs are not heavily regulated and are usually governed and held accountable by their membership (they may or may not be an incorporated organisation). Licensed clubs are, however, closely regulated and are those clubs with licences for the sale of liquor and, if approved, the provision of electronic gaming machines.

In the ACT gaming licences became available to clubs in the mid 1970s and this period marks the beginning of the contemporary licensed club sector. Of particular note, gaming licences significantly increased the capacity of clubs to generate funds and further the interests of their members.

Since its humble beginnings the licensed club industry has grown appreciably. This has occurred through the formation of new clubs, various amalgamations and the continuing expansion of existing clubs.

In the ACT there are currently 59 licensed clubs and many residents are members of more than one. ClubsACT reported that licensed clubs employed 2177 people in 2007¹ and in the 2008-09 financial year licensed clubs took \$174.5m in gaming machine revenue from 5,085 gaming machines².

The expansion of the licensed club industry has occurred under the ACT's community gaming model. The principle underpinning this model is that the revenue from gaming machines must be returned to the community through the services and facilities provided by clubs to their members and more broadly through contributions to community organisations. Certain commercial operators (namely hotels and taverns) do have access to small numbers of less profitable class B machines, but the highly profitable class C machines are exclusively available to not-for-profit licensed clubs.³

Since 1 June 2001 clubs have been required to make monetary and in-kind contributions to the community under a legislated community contributions scheme. Prior to then, many clubs were making contributions to the community however the legislative scheme formalised this process and established a minimum level of eligible contributions.

¹ ClubsACT (2009) Submission to the Productivity Commission's Inquiry into Australia's Gambling Industries, p. 33.

² ACT Gambling and Racing Commission (2009) Community Contributions made by Gaming Machine Licensees 1 July 2008 to 30 June 2009, pp. 20-21.

³ Taverns may apply for no more than two machines. Hotels may apply for up to 10 machines.

In the 2008-09 financial year licensed clubs made compulsory and voluntary community contributions to the value of \$13.8m which includes both monetary and in-kind contributions.⁴ In-kind contributions include club services and facilities provided to organisations without charge or at less than the market rate. For example, some licensed clubs provide meeting rooms to organisations at no charge. This is considered an in-kind contribution and the monetary value of the room at the regular room hire rate is recorded as a community contribution.

Of clubs' total community contributions in 2008-09, 70.10% were for sport and recreation purposes, 15.41% went to non-profit activities while 8.33% was contributed to charitable and social welfare and 1.62% to community infrastructure.⁵

2.2 Gaming machine licensing requirements

To obtain a gaming machine licence in the ACT clubs must be “eligible” clubs as defined by the GMA. For the purposes of this review, the relevant elements of this definition are that clubs must:

- be incorporated (either as a corporation under the *Corporations Act 2001* (C'th) or as an incorporated association under the *Associations Incorporation Act 1991*);
- have eligible objects as their main objects;⁶
- be conducted mainly to achieve their eligible objects; and
- keep and maintain the club and its facilities for the benefit of members generally.

These provisions ensure that, in accordance with the community gaming model, only not-for-profit organisations which have been established for a common purpose for the benefit of members may operate gaming machines.

To retain a gaming machine licence clubs must remain “eligible” clubs. They must also comply with a number of other conditions in the GMA, including provisions relating to the governance of the club. In terms of governance, the GMA provides that:

- voting members as a group must have complete control over the election of all board members, except in the case of board members appointed by an associated organisation;

⁴ ACT Gambling and Racing Commission (2009) Community contribution made by Gaming Machine Licensees 1 July 2008 to 30 June 2009, pp. 20-21.

⁵ ACT Gambling and Racing Commission (2009) Community contribution made by Gaming Machine Licensees Attachment D, pp. 20-23.

⁶ Eligible objects are outlined in Section 145 of the GMA and include anything that furthers or promotes recreation, social, religious, political, literary, scientific, artistic, sporting or athletic purposes and cultural or educational purposes.

- each voting member must have an equal right to elect people, and to nominate or otherwise choose people for election, to the club's management committee or board, except in the case of board members appointed by an associated organisation;
- the election of a board member must not be decided, controlled or influenced in a significant way by people other than voting members, or by only some voting members, except in the case of board members appointed by an associated organisation;
- a club must have at least 300 voting members and the number of life members of the club must not be more than 5% of the number of voting members of the club;
- a club must not be used as a device for individual gain or commercial gain by someone other than the club;
- club facilities and benefits must be available equally to all voting members;
- proceeds from the conduct of gaming must be used in a way that promotes the objects of the licensee;
- the licensee must follow its objects or purposes honestly and seriously;
- payments made under the licensee's objects must be in the best interests of the licensee's members; and
- payments made for things bought by the licensee and the remuneration of employees and executives must be reasonable.

2.3 The role of board directors

A club's board of directors is responsible for overseeing and monitoring the operations of the club, managing its affairs and setting its direction. For example, a club's board may make decisions relating to the acquisition of assets, capital works or approving new member applications. The framework for the board's structure and powers is usually set out in the club's constitution and in addition club directors must comply with the GMA and corporations law.

The Corporations Act 2001 (C'th) allows directors to exercise all the powers of a company other than those limited to general meetings. The Act requires that a director or other officer of a corporation exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose.⁷ The Corporations Act 2001 also sets out other requirements concerning things such as the election of directors and the conduct and recording of board meetings and board decisions.

⁷ Section 181 *Corporations Act 2001* (C'th).

In addition to the governance provisions outlined earlier, the key governance provision in the GMA for directors is the requirement for a club's board to have complete control over the club's business or operations. Disciplinary action, including suspension or cancellation of a club's gaming machine licence, can be taken against a licensee if it is found that the club's board did or does not have complete control over a significant aspect of the club's business or operations.⁸ This provision is central to the community gaming model as it is intended to prevent clubs from being controlled by external parties, and in effect, directed to act in a way that is not in the best interests of the club and its members.

Regardless of provisions in corporations law and the GMA, it is also arguable that directors have an obligation under common law to act in the best interests of their club. In this regard this common law obligation applies to clubs incorporated under the Associations Incorporations Act 1991 and not the Corporations Act 2001.

2.4 The role of the club membership

The GMA provides that the membership of a club is the fundamental foundation of the club. This is despite the significance of the relationship between a club and its associated organisation. Under the GMA clubs must exist to provide benefits to their members and to pursue a common purpose.

Although some clubs have an open or "democratic" approach to the voting rights of their membership (ie all ordinary members have voting rights), this is not a requirement of the GMA. The GMA only requires that a club have at least 300 voting members, with not more than 5% of those being life members.⁹ In practice, many clubs have a number of different membership categories, only some of which have voting rights. General members without voting rights usually form the vast majority of the membership.

Where a club has an approved associated organisation,¹⁰ voting members may not have the capacity to appoint all directors of the club's board. However, voting members of clubs that are corporations (including those with directors appointed by an associated organisation) have some avenues of control through corporations law. For example, section 203D of the *Corporations Act 2001* allows voting members to remove any board member by resolution at a general meeting. Voting members may also nominate and elect a new board member in the same way.

In terms of responsibilities, members of a club (in similar terms to the shareholders of a company) have their liability for a club's debt limited to the member's subscriptions payable under the club's constitution or articles. However, club members do not have access to the proceeds of the sale of assets or surplus funds in the event of the club winding up.

⁸ Sections 14(h) and 39A of the *Gaming Machine Act 2004*.

⁹ The GMA's 5% limit on life memberships within the voting membership was intended to ensure the voting membership was not dominated by a small and disproportionately powerful group.

¹⁰ Section 147 of the *Gaming Machine Act 2004*.

2.5 The role of associated organisations

As indicated in section 2.4 above, the GMA provides for certain approved external parties, defined as associated organisations, to have a significant influence over the governance of a club through the appointment of directors. Associated organisations usually appoint the majority of a club's directors and may also have rights in relation to removing directors and approving changes to a club's constitution. Approximately one third of the clubs in the ACT have an associated organisation and in most cases this has been a longstanding relationship.

Associated organisations must be approved by the Commission and established under the same organisational principles and pursue the same eligible objects as the club itself. The Commission must assess and be satisfied that the potential associated organisation would help the club to achieve its eligible objects. A club and an associated organisation are therefore two separate entities that should be working in cooperation towards common goals in a mutually beneficial arrangement.

This arrangement that allows associated organisations to appoint a majority of directors has the ability to protect the core objects of a club by preventing a majority of directors elected from the membership to make a fundamental change to the club's objects or direction. This arrangement is used by clubs to ensure that resources are primarily allocated to achieve their objects.¹¹ It is on this basis that associated organisations have been allowed to have such a significant role in the governance of clubs.

2.6 The role of the gambling regulator

Under the *Gambling and Racing Control Act 1999* the Commission is tasked with administering the gaming laws and controlling, supervising and regulating gaming in the Territory. This Act requires the Commission to perform its functions in a way that best promotes the public interest and in particular, as far as practicable, promotes consumer protection, minimises the possibility of criminal or unethical activity and reduces the risk and costs, to the community and individuals concerned, of problem gambling.

The administration of the GMA, including the various provisions relating to club governance, is achieved primarily through the Commission's gaming regulation and compliance programs. Among other things these programs involve the Commission approving and monitoring the influential persons associated with a gaming machine licensee, scrutinising the transfer of licences, examining annual and monthly financial reports and assessing compliance with voting member requirements.

In relation to associated organisations, the Commission's current role is assessing and, if appropriate, approving associated organisations. Once the approval process is complete, the Commission's role focuses on the club rather than its associated organisation. It has no powers to monitor associated organisations, nor does it have an explicit power to revoke an approval.

¹¹ Section 55(a) of the *Gaming Machine Act 2004* requires licensees to use the proceeds from gaming in a way that promotes its objects.

2.7 Principles of good corporate governance

Corporate governance is the arrangement and nature of processes that direct and control an organisation.

Ensuring good corporate governance is becoming increasingly integral to managing any organisation. A sound approach to governance helps to ensure that an organisation acts in the interest of its members or shareholders, makes effective decisions and maintains transparency and accountability.

While this review has focused on only some aspects of corporate governance, the Commission has examined these within the context of the broader discussions on corporate governance. In this regard the Commission has reviewed a number of industry and government documents that provide useful commentary or guidance on corporate governance such as those by the Organisation for Economic Cooperation and Development (OECD), the Australian Sports Commission (ASC)¹² and the Australian Stock Exchange (ASX)¹³.

Despite the fact that much of the discourse on corporate governance uses language specific to corporations and their shareholders, the principles of good corporate governance are also applicable to community based not-for-profit organisations and their members. In addition, the Commission notes that there is also the view that where organisations receive benefits from the government they should be held accountable to these principles. This is illustrated by the Australian Sports Commission (ASC) which has a “clearly stated position with respect to the governance of national sporting organisations to which the ASC provides taxpayer moneys”.¹⁴ In return for receiving a benefit from taxpayers the ASC expects funded organisations to comply with the principles of governance contained in the ASC’s good practice guide for sporting organisations.

While clubs are not taxpayer funded, clubs are granted a monopoly over more profitable class C gaming machines by the Government as part of the community gaming model where hotels and taverns are restricted to less profitable class B gaming machines and other organisations (including the casino) are prohibited from operating gaming machines altogether. In addition, the club industry in the ACT, in comparison to commercial pubs and taverns, receives tax concessions through lower tax rates on gaming machine revenue. As with any other form of tax concession, the impact of these lower rates in conjunction with the club’s monopoly on the more profitable gaming machines is that the general community bears a cost through lower tax revenues and therefore less funding for services than would otherwise be the case.

¹² The ASC provides funding from taxpayers to not-for-profit sporting organisations nationally. These sporting organisations are typically supported by volunteers and controlled by volunteer boards.

¹³ The ASX principles are not mandatory, however if ASX listed companies do not comply with the ASX good governance principles then they are required to explain why. See ASX (2007) *Corporate Governance Principles and Recommendations*, Second Edition p. 5.

<http://asx.ice4.interactiveinvestor.com.au/ASX0701/Corporate%20Governance%20Principles/EN/body.aspx?z=1&p=-1&v=1&uid=>

¹⁴ Australian Sports Commission (2007) *Governance Principles: A Good Practice Guide for Sporting Organisations*, p. 1.

http://www.ausport.gov.au/_data/assets/pdf_file/0004/193027/ASC_Governance_Principles_2007.pdf

2.8 Common corporate governance principles

Good corporate governance is the key element of this review and benchmarking with other industries or examples is a matter worthy of consideration. The following principles (or principles to their effect) in relation to transparency and accountability are common to the good corporate governance documents of the ASX, the ASC and the OECD.

- Shareholders should elect the majority of the board.¹⁵
- The majority of directors should be independent, that is, non-executive directors who are not members of management and who are free of any business or other relationship that could (or be perceived to) materially interfere with the independent exercise of their judgement.¹⁶
- Board members should act on a fully informed basis, in good faith, with due diligence, and in the best interest of the company and the shareholders.¹⁷

While comparisons between industries can be difficult, these principles are fundamental to good governance arrangements and are explored further in this review.

2.9 ClubsACT Code of Governance

In 2005 ClubsACT published a self-regulatory Code of Governance. As noted at the time by ClubsACT, a Code of Governance was necessitated by the growth, diversity and increasingly commercial nature of the clubs industry:

The clubs industry has grown significantly over the past couple of decades, its activities are extensive, its operations more complex, it is increasingly subject to corporate laws, the distinction between clubs and other businesses have blurred (especially in other jurisdictions), and the expectations of the community have increased and the club industry must respond, and possibly be ahead, of this more demanding operating environment.¹⁸

The Code of Governance was an important step in recognising the changing demands of the club sector in 2005. However, the Commission notes that in terms of the governance issues being examined as part of this review, the Code does not impose any additional requirements on clubs beyond the current legislative requirements of the GMA.

For example, in relation to board elections the ClubsACT Code provides:

We are committed to promoting fair and democratic elections and maximising voting member involvement by following appropriate procedures for the conduct of club elections and for the conduct of ballots (required for the application of an initial/new licence, as well as for the amendment, transfer or a surrender of a licence).¹⁹

¹⁵ Shareholders of a company may vote in company resolutions, including the election and removal of directors – see Part 2G.2 and part 2D.3 of the *Corporations Act 2001* – underlying principle in ASX recommendations, ASC principle 1.4, OECD principle IIA.

¹⁶ ASX recommendation 2.1, OECD principle VI E, ASC principle 1.7.

¹⁷ ASC principle 1.10, OECD principle VIA, ASX principle 3.

¹⁸ ClubsACT (2005) Code of Governance for the ACT Club Industry, p. 4.

¹⁹ ClubsACT (2005) Code of Governance for the ACT Club Industry, p. 7.

The ClubsACT Code provides a basic reference document covering fundamental principles of club operations. It is not a “best practice” document and is mainly written in generic terms. There have been no changes to the Code since its inception in 2005. While a complaints mechanism has been established under the Code²⁰ there is no pro-active reporting on, monitoring or auditing of compliance with the Code by the industry.

²⁰ ClubsACT (2005) Code of Governance for the ACT Club Industry, p. 9.

3. Key Issues and Recommendations

The Commission's Issues Paper circulated for comment as part of the stage one public consultation process was largely focused on the potential for a disagreement between a club and its associated organisation over a particular matter and the impact this may have on the governance of the club. In these circumstances, directors that have been appointed by the associated organisation may experience significant pressure to act in a way that they may consider is not in the club's best interests and in doing so risk breaching requirements in the GMA and corporations law.

In addition, the Issues Paper noted that many clubs significantly restrict the number of eligible voting members. This could be considered less transparent and less democratic than contemplated by the best practice set up of a club as a not-for-profit mutual entity established for the benefit of its members.

The more remote a club's governance arrangements are from a transparent open model where the members make decisions for their mutual benefit the more difficult it becomes to justify the claim for these benefits under the mutuality principle.

The principle of mutuality provides a significant benefit to many organisations in Australia by exempting certain funds from income tax.²¹ It applies to many not-for-profit clubs (such as the club industry in the ACT) and sporting organisations. Many of these entities would not exist without the significant income tax concessions afforded to them by the principle of mutuality.

As clubs have grown larger and now offer an increasingly diverse range of quasi-commercial services and facilities there has been some discussion about the extent to which they can be considered as mutual entities. This is particularly in the context of having a membership base that frequently has little affiliation with the objects of the club and no control over the governance of the club. For example, the Industry Commission noted this issue in a report in 1996.²² More recently the Henry Tax Review recognised these circumstances in the following finding:

Where NFP clubs operate large trading activities in the fields of gaming, catering, entertainment and hospitality, the rationale for exempting receipts from these activities from income tax on the basis of a direct connection with members is weakened.²³

²¹ Where a common fund is contributed to and controlled by a number of people for a common non-commercial purpose, any residual amount remaining in the fund after it has been applied to the common purpose is not considered income. The residual amount is considered a surplus of capital and is, therefore, not subject to *income* tax. Funds derived from external sources (investments, interest and sales to separate parties) are taxed as usual.

²² "The principle of mutuality is soundly based. However, given the changing nature and scope of some large clubs the Tax Commissioner may need to review their eligibility for access to concessions under the mutuality principle." Industry Commission (1996) *tourism Accommodation and Training*, p. 176.

²³ The Treasury (2010) *Australia's Future Tax System*, p. 210 <http://taxreview.treasury.gov.au>

The Issues Paper outlined three possible approaches to governance (including the status quo) and sought feedback on these and any other alternative approaches from stakeholders and the community. Underpinning the approaches were the following key issues:

- the role and powers of associated organisations;
- obligations of club directors;
- powers of the Commission; and
- democratic election processes.

The Commission has considered the submissions received in response to the Issues Paper and this chapter provides commentary on the issues and outlines the Commission's conclusions and recommendations on each of the key matters stated above.

3.1 The role and powers of associated organisations

3.1.1 Issue

The GMA currently gives associated organisations the power to appoint and remove the directors of a club. In light of the potential for a conflict of interest to emerge between the club and the associated organisation over a particular matter this review has considered what powers associated organisations should have to appoint and/or remove directors of clubs.

3.1.2 Discussion

It is possible that a club and its associated organisation may have a significant disagreement or conflict over a particular matter or competing interest. In these circumstances, directors who have been appointed by the associated organisation (and in particular who can be removed or sanctioned in some way by that organisation) may experience significant pressure to act in a way that they may consider is not in the club's best interests.

In this regard, there is a possible risk to a club board's compliance with the requirement in the GMA²⁴ to have complete control over the club's business or operations and the requirements under corporations law²⁵ for directors to act in the best interests of the club (where the club is incorporated under the Corporations Act 2001 (C'th)).

Issues of control over a corporation's Board of Directors occur not only in the Territory's club industry but also more broadly in the corporate sector. While there are some unique elements to this issue in terms of particular provisions in the GMA, the issue of external influence is an issue for all corporate boards. The lobbying of directors and attempts to influence their decision-making are all part of normal corporate activity.

In response to the issue of the potential for a conflict of interest, industry submissions argued that there is no market failure to justify regulatory change and that regulatory change on this basis would be contrary to COAG commitments to regulatory reform. Industry submissions noted that the current structure of board appointments by a third

²⁴ See Section 14(1)(h) of the GMA.

²⁵ See Part 2D.1, Division 1 of the *Corporations Act 2001*.

party is not unlike a parent/subsidiary relationship which is allowed under corporations law and corporations law also expressly provides that directors must exercise their powers in the best interests of the club. In essence, the industry argument is that a potential conflict, particularly when there are existing remedies, is not sufficient grounds for legislated regulatory reform.

Of key concern for industry was that in the absence of directors appointed by associated organisations clubs would be vulnerable to takeovers that would result in changes to the club's original purpose and objects. For example, a club that had supported rugby league for 20 years could become a club supporting rugby union if the majority of the board's directors (some of whom could have just been appointed) supported rugby union rather than rugby league.

While the Commission proposed a number of options for protecting the core objects of a club through legislation, industry was concerned that none of them would be fully effective in stopping an alternative interest group from getting control of a Board or diverting significant financial resources to a competing activity. They were also concerned that such changes could have unintended consequences such as unduly limiting the freedom of directors to make decisions about a club's expenditure.

The Commission recognises that "locking in" a club's core objects for the purposes of maintaining eligibility for a gaming machine licence would have other consequences. One significant consequence being that it would prevent the voting membership of the club from changing the direction of the club to other equally lawful core objects. While potentially protecting those clubs that currently use associated organisations to appoint a majority of directors (approximately one third of the current licensees) it would also limit the future direction of these entities.

For these reasons, despite the potential for a conflict of interest and the risks this may pose, the Commission considers it appropriate for associated organisations to continue to appoint directors.

The Commission does not, however, consider it appropriate for associated organisations to be able to appoint all of the directors on a board. It is an important governance requirement that a board's members have a variety of qualifications and interests to ensure that decisions or issues being discussed are given an appropriately broad consideration. The Commission therefore considers that an associated organisation's ability to appoint directors ceases to benefit the club or community when the percentage of appointed directors on the board reaches a certain threshold. For example, if a board were made up entirely of directors appointed by an associated organisation it is unlikely to have the range of attitudes and interests that would always ensure broadly considered decisions. The Commission considers that all club boards should have some "independent" directors (ie. appointed by a different method) while noting that good corporate governance principles suggest a majority of directors should be independent. The Commission also recognises that to be effective in their role as "custodians" of a club's objects, there arguably needs to be a majority of directors appointed by the associated organisation on the board.

The GMA does not limit the number or proportion of directors that may be appointed by an associated organisation. While no club's constitution currently provides for all of its directors to be appointed by an associated organisation the Commission considers that it is important to ensure this cannot occur in the future. The Commission considers that it would be appropriate for the GMA to establish a minimum percentage of board directors to be elected by the voting membership, with this being set initially at 25%. Over time, this could be increased if this was considered desirable or necessary.

While the Commission accepts the rationale for allowing associated organisations to appoint directors, it is less clear that they should be able to remove directors. The Commission considers that the threat of removal exacerbates the risks posed by the potential for a conflict of interest. In other words, in light of the pressure it may bring about, the associated organisation's power to remove directors could be considered a greater risk to the club's interests than it is a benefit.

Corporations law currently provides a process for members to remove and replace directors.²⁶ In a situation where a director is not performing satisfactorily, or for some other reason, the membership may choose to call a general meeting and vote to remove the director, and where appropriate, elect a replacement. The Commission considers that these powers are adequate and it is difficult to envisage a situation where the interests of the club could only be served by an associated organisation removing a director. If a director nominated by the associated organisation is removed by the membership, it would not be intended for the GMA to prevent the associated organisation from nominating the replacement director.

3.1.3 Conclusion

While the Commission considers that a wholesale change to the role of associated organisations as contemplated by the GMA is not warranted to mitigate against the risks associated with potential conflicts of interest, it does consider it appropriate to limit some of the powers of associated organisations. Specifically, the Commission considers that associated organisations should only be able to appoint some and not all of a club's directors and that they should not have an explicit power to remove directors. It is considered that such limits on the powers of associated organisations would not significantly reduce the safeguards provided by the associated organisation model but they would materially reduce the likelihood of a conflict of interest arising.

Recommendation 1

The Commission recommends that the GMA be amended to:

- ensure associated organisations do not have the power to remove directors;
and
- provide for voting members to elect at least 25% of board directors.

²⁶ Section 203D *Corporations Act 2001* (C'th).

3.2 Obligations of club directors

3.2.1 Issue

Currently the GMA, corporations law and common law provide the framework for obligations on club directors. As noted in section 2 Background of this report, some of the key obligations are only in corporations law or common law and not the GMA. In light of this, the review has considered whether the existing obligations in the GMA are sufficient.

3.2.2 Discussion

The key duty of a director of an organisation is to make decisions and act in the best interests of the organisation. This means that a director must resist outside lobbying, directions or coercion and decide an issue based on the net effect of each option on the organisation's interests. It also means that a director should not favour another organisation or individual at the expense of the organisation for which they are a director. This fundamental duty is codified in corporations law²⁷ and exists in common law. It does not however exist in the GMA and there are no other specific provisions in the GMA that hold individual directors to account for their actions while directors of a club board.

The responsibility for maintaining compliance with corporations law lies with the Australian Securities and Investment Commission (ASIC). ASIC's broad responsibilities and national and international priorities mean there is a risk that the kind of breaches that may occur at a club level in the ACT may not warrant the application of resources by ASIC to investigate and, if necessary, take enforcement action. This places the Commission in a difficult position where it must rely on an external regulator with national priorities to take action on issues that may not be of national importance, yet from ACT regulatory perspective, have a high local significance.

The Commission also notes that it is not a requirement for all clubs to be corporations (ie subject to corporations law) and there are currently 14 clubs in the ACT that fall under the relevant threshold and are only incorporated associations²⁸. The directors of these clubs are therefore not subject to corporations law requiring directors to act in the best interests of the club and only have common law duties to this effect. While it is technically possible for the Commission to commence action against a club on a common law basis it would be highly unusual (and costly) for a regulator to do so.

3.2.3 Conclusion

Given the importance of a "best interests" type of provision as the key mechanism for holding directors to account, the Commission is of the view that such a provision should be included in the GMA. Advice obtained by the Commission indicates in general terms that such a provision could be drafted without creating ambiguity or conflict with Federal corporations law.

²⁷ Section 181 *Corporations Act 2001* (C'th).

²⁸ Section 186 of the *Gaming Machine Act 2004* provides a (continuing) transitional arrangement that licensees with annual gross revenue of less than \$500,000 do not need to be incorporated under the *Corporations Act 2001* (C'th).

Such a provision would consolidate the regulatory control of this aspect of a club's operation within the Gambling and Racing Commission's powers as the existing local regulator.

Recommendation 2

The Commission recommends that the GMA be amended to:

- require directors to discharge their powers and duties in the best interests of the club and for a proper purpose consistent with corporations law.

3.3 Powers of the Commission

This review has considered what additional powers, if any, the Commission should have regarding the governance of clubs. In particular, the Commission has reviewed the adequacy of its powers in relation to club constitutions and associated organisations. These two areas are discussed separately below.

3.3.1 Powers relating to conflicting constitutions

3.3.1.1 Issue

Currently the Commission has no power to require club constitutions that may contain rules and provisions that conflict with the GMA and the other gaming laws (such as the mandatory gambling Code of Practice) to be amended so that they are consistent with the Territory's gaming laws. For instance, a club's constitution may permit non-members who have not been signed in to use gaming machines, which would constitute a breach of the GMA. Such a situation places the club at risk of breaching the gaming laws even though they are operating in accordance with their constitution.

3.3.1.2 Discussion

A club's constitution is intended to define a club's nature and direction and set out the rights and responsibilities of members and directors - it is a key governance document. Because of its importance as a document describing what may and may not be done, if a constitution is inconsistent with the gaming laws, the risk of non-compliance with those laws is increased along with possible disciplinary action.

The Commission is also of the view that it is not appropriate for clubs to make rules which are inconsistent with their legal obligations. The Commission considers that the clubs' status as community not-for-profit organisations which receive sizeable concessions from government, including a monopoly on class C gaming machines, confers an imperative in this regard.

In their submissions to the Commission, industry expressed the view that should the Commission have the power to require change to a club's constitution this would "leave open the possibility of people determining outcomes that should be made by a club's board

and its members”.²⁹ While noting the concern that if the Commission had such a power it would be intervening in a club’s governance, the Commission would only do so where it was clear that a conflict existed between a club’s constitution and the gaming laws, ie. it would only act in circumstances where the board and its members had failed to make rules that were consistent with the gaming laws.

The Commission currently has a general directions power in the GMA which could be used by the Commission to direct a club to change its constitution. However, given the significance of a direction to change a constitution, the Commission considers that it would be more appropriate for the Commission to have a clearly defined and specific power. The Commission is also of the view that a specific legislated power would more clearly communicate the expectations and requirement of clubs to have constitutions that do not conflict with the gaming laws.

The Commission notes that in practice clubs often have difficulties making changes to their constitutions and consequently it may not be sufficient for the Commission to direct a constitution be changed for that change to be enacted. For example, the Commission recognises the difficulties in holding a general meeting and securing a quorum to vote on what may be a technical change to a club’s constitution (which may at least partially explain a number of club constitutions that have outdated provisions such as references to liquor or gaming Acts that have long since been repealed).

To address this issue and to ensure the power to require change was effective, club constitutions would need to be amended to include a provision which enables the constitution to be amended without a vote by members if the club has been directed to amend its constitution by the Commission. In turn, having this sort of provision in a club constitution would need to be a condition for holding a gaming machine licence.

3.3.1.3 Conclusion

Clubs have a responsibility to be fully compliant with applicable legislation. Clubs should not have provisions that allow for (or encourage) unlawful activity in their constitutions and the Commission considers that there should be a mechanism for ensuring conflicting provisions are removed.

Recommendation 3

The Commission recommends that the GMA be amended to:

- provide the Commission with the power to direct a club to amend their constitution where a conflict exists between a provision in the constitution and a gaming law, or where provisions grant a power which if exercised would constitute a conflict; and
- require, as a condition of a gaming machine licence, that a club’s constitution include a provision that enables the constitution to be amended without a vote by members where the club has been so directed by the Commission.

²⁹ ClubsACT submission p. 9.

3.3.2 Powers relating to associated organisations

3.3.2.1 Issue

Associated organisations have an important role in the club industry because once granted an approval as an associated organisation they can appoint directors, including a majority of directors, to a club's board. However, beyond the initial approval process the GMA currently does not provide the Commission with any specific powers to monitor or investigate associated organisations. The GMA also does not include an explicit power to revoke the approval of an associated organisation once that approval has been granted.

3.3.2.2 Discussion

As noted in section 2 *Background*, the Commission must approve associated organisations and in doing so must be satisfied that the organisation will help a club achieve its eligible objects. An approval process is necessary because associated organisations can have a significant influence over a club through their involvement in a club's governance arrangements. The Commission therefore needs to be confident that the relationship is appropriate and will be a benefit to the club.

Although a potential associated organisation may be well positioned to help a club achieve its eligible objects at the time it is approved, both clubs and associated organisations are likely to change over time, and this may not always be the case. The Commission currently has no powers to monitor associated organisations and therefore has no capacity to assess whether over time an associated organisation is continuing to help a club achieve its eligible objects.

Moreover, in the event that the Commission was to have serious concerns about the relationship between an associated organisation and a club it has no explicit capacity in the GMA to revoke the approval of an associated organisation. The Commission notes that current legislative practice is for legislation to ensure that where there is a power to make an approval there should also be a specific and transparent provision for revoking an approval. This ensures that there is clarity about the nature of the approval (including its duration) and procedural fairness to the organisation if the decision-maker acts to revoke the approval.

3.3.2.3 Conclusion

If associated organisations are to continue having a dominant role in some clubs' governance, the Commission considers that it is appropriate for it to have some powers to monitor them, particularly the extent to which they are continuing to help clubs achieve their objects. In the event that an associated organisation is no longer considered appropriate to be formally associated with a club under the GMA, that is, to have the power to appoint board directors, the Commission is of the view that it should be able to investigate and suspend or revoke their status as an associated organisation. Obviously the necessary review procedures should be available to the relevant body.

Recommendation 4

The Commission recommends that the GMA be amended to provide the Commission with powers to:

- investigate the operations of an associated organisation and request relevant documents or information (for example financial statements and board minutes) where there are reasonable concerns that the associated organisation has changed its objects, is no longer assisting the club to meet its eligible objects or that the relationship is impacting detrimentally on the club's governance; and
- suspend or revoke the approval of an associated organisation (subject to appropriate review mechanisms) if it no longer meets the requirements of the GMA.

3.4 Democratic election processes

3.4.1 Issue

A number of clubs' governance arrangements are clearly out of step with accepted good corporate governance principles. In particular, provisions that limit voting rights to a small minority of members combined with those that provide for the majority of board directors to be appointed rather than elected by the broader voting membership are contrary to good governance principles. As discussed above, there are a number of reasons why these sorts of provisions are allowed and the Commission has concluded as part of this review that it is not appropriate to remove the capacity for associated organisations to appoint board directors.

However, the Commission considers that the club industry should take responsibility for improving its governance provisions to increase the transparency and accountability of their operations.

3.4.2 Discussion

The Background section of this report noted that many clubs significantly restrict their voting memberships in addition to providing for the majority of directors to be appointed by an associated organisation. The combination of these measures means that ordinary members may have little or no capacity to participate in the governance of the club. While the Commission accepts that there may be many members of clubs that have no desire to be involved in the governance of the club, the fact that they cannot, even if they wished to, does not represent an ideal governance arrangement for a community based club that has been established for the benefit of its members.

The ClubsACT Code of Governance, released in April 2005, provides some generic guidance for member clubs in terms of operations and legislative compliance. It does not provide any guidance on "best practice" or benchmarking for industry members to strive for to achieve improved open management practices.

The unique corporate relationship between club members and their board does not necessarily encourage good governance arrangements through open board election

processes. One of the reasons for this is that club members do not have a direct financial interest in the club's operations.

In a corporation other than a club the shareholders have a direct financial interest in the performance of the company. This financial interest provides a strong incentive for shareholders to hold boards accountable for their decisions and is one of the safeguards against ineffective performance and governance within a company. In contrast, members of clubs have no direct financial interest in their clubs and can only benefit from improved or additional facilities. For this reason, and as the Productivity Commission has noted, "the governance arrangements in clubs may be weaker than those in most private commercial businesses".³⁰

The Commission also notes that while members in small not-for-profit organisations, such as the small licensed clubs, are more likely to have a strong non-financial interest and a direct connection to the organisation, this is less likely to be the case for members in large clubs. In effect, as a club grows and diversifies the direct connection and the non-financial interest of the membership is likely to be weakened.

The Commission notes that while industry submissions opposed requiring more democratic election processes in the GMA there are a number of very successful clubs in the ACT that provide voting rights to all ordinary members and who in turn elect all of the board directors.

3.4.3 Conclusion

As not-for-profit community organisations that receive significant tax concessions and exclusive use of class C gaming machines, clubs have a responsibility to develop and maintain systems of governance that are transparent and accountable. Clubs might primarily achieve better governance by fostering transparency in decision making processes and moving towards a model of complete accountability to members where this does not currently occur.

In order to improve existing governance arrangements the Commission does not consider that a legislative approach that provides a "one size fits all" is appropriate at this point in time.

Instead, the opportunity exists for the ACT club industry to address and facilitate this issue by demonstrating its commitment to generally improving its current control arrangements. The Commission considers that the existing ClubsACT Code of Governance should be reviewed by industry and strengthened to ensure that it provides a more comprehensive "best practice" model for clubs to follow. Some self regulation in this area, such as monitoring or auditing member progress and publishing the results, would indicate that the industry was serious about improving its operations and governance practices.

³⁰ Productivity Commission (1999) *Australia's Gambling Industries: Inquiry Report*, p. 21.27.

The success of this self-regulation should be monitored by Government with a view that if some improvement in governance arrangements has not been achieved by some specified future date then legislative encouragement should be considered.

Recommendation 5

The Commission recommends that the Minister write to ClubsACT requesting that the ClubsACT Code of Governance be reviewed and updated to include “best practice” provisions to improve club accountability and transparency to their members. The Minister could require the Commission to monitor the progress of the review and the application of the results and provide advice back to the Minister in due course whether legislative reform is required in this area.

4. Other Regulatory Issues

A number of provisions in the GMA relating to club governance in general were also considered as part of this review. Specifically, sections 13, 14, 53, 55, 145 and 146 of the GMA were considered to determine whether these sections needed enhancing or clarifying to improve their operations.

Based on the Commission's regulatory experience with these provisions, it was concluded that some of the above listed sections do not need any modification while in contrast a number of sections would benefit from enhancement or clarification. Further, it was concluded that some sections should be repealed.

No submissions from stage one of the consultation process commented on the need to review these provisions.

The following amendments are proposed to the identified sections of the GMA:

- i) *Section 14(1)(a)*: Currently this section provides that a ground for refusing to issue a gaming machine licence exists if payments for the rental or lease of the club's premises are unreasonable or are related to the level of gaming machine performance.

It is proposed that this section be amended to remove the provision relating to payments having to be reasonable as this provision is extremely difficult to enforce and adds little value. Further, the remainder of the section should be enhanced by broadening the restriction on payments relating to gaming machine performance to apply to all goods and services (including the supply of gaming machines and venue rental or lease payments). This would ensure that third party suppliers do not become de facto gaming machine operators by directly obtaining a proportion of gaming machine revenue.

- ii) *Section 53(4)(a)*: In relation to inequitable benefits, currently this section provides that a person is entitled to a benefit if it was obtained in the course of acting on behalf of the club.

It is proposed that this section be clarified by adding to the description of acting on behalf of the club that it includes a person performing their normal duties as an employee or director of the club.

- iii) *Section 53(4)(b)*: In relation to inequitable benefits, currently this section qualifies section 53(4)(a) of the GMA by specifying what the benefit may consist of reasonable food or refreshment or out-of-pocket expenses reasonably incurred and authorised by a resolution of the club's management committee or board.

It is proposed that this section be clarified and enhanced by providing that it includes an expense paid by someone else in relation to the person's duties (such as free entry to a conference) and authorised by a resolution of the club's management committee or board. Further, the details of any benefit obtained, (including a description of the benefit, the purpose for which it was provided, the

amount or value and the position of the person receiving the benefit) should be published in the club's annual report.

- iv) *Section 54*: Currently this section specifies that information about certain contractual arrangements and remuneration must be published in a club's annual report. However, there is no clarity about what information must be published.

It is proposed that this section be clarified so that the information to be published must include the relevant person's position in relation to an influential person or a person's remuneration, the purpose of the expenditure or contract and the amount for that financial year or for a longer period that must be specified.

- v) *Section 55(d)*: Currently it is a condition of a licence that payments made for things bought by the licensee are reasonable. This section is largely covered by the section 55(c) of the GMA which provides that payments made under the licensee's objects are in the best interests of the licensee's members. In similar terms to section 14(1)(a) of the GMA outlined above, it is extremely difficult to regulate a provision that requires a judgement on whether a payment is reasonable.

It is proposed that this section be repealed.

Recommendation 6

The Commission recommends that amendments to sections 14(1)(a), 53(4)(a), 53(4)(b), 54 and 55(d) of the GMA be undertaken as outlined in the review report.