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Sent: Tuesday, 19 July 2011 3:41 PM
To: 'Shara Murray'
Subject: [2767947:21] Private and confidential
Attachments: Letter - Chairman of Racing Queensland Limited - Executive strategy(10820366_3).DOC;
Letter - Chairman of Racing Queensland Limited - Executive strategy(10820366_4).DOC

Hi Shara

Please see attached draft as requested yesterday. We have tracked our changes for your convenience. We also include a clean draft.

Please let me know if you are ready for us to send you the final version to provide to the Board.

Please let me know if you have any queries or would like to discuss.

Kind regards

Murray

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19 July 2011

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Dear Shara

Executive retention strategy

1 Instructions

1.1 We have been instructed to advise the Board of Directors of Racing Queensland Limited (Board) in relation to a retention strategy for the following executives of Racing Queensland Limited (RQL):

- (1) Mr Malcolm Tuttle, Chief Executive Officer;
 - (2) Mr Jamie Orchard, Director Integrity Operations;
 - (3) Mr Paul Brennan, Director Product Development; and
 - (4) Ms Shara Murray, Senior Corporate Counsel,
- (collectively referred to as the **Executives**).

1.2 The Board has instructed us to advise on options available to it to address the ongoing need to retain and reward high performing executives in an environment of uncertainty, taking into account the legal obligations imposed on the Board in determining an appropriate level of remuneration and benefits.

1.3 In this letter we have:

- (1) considered the general obligations imposed on the Board under the *Corporations Act 2001* (Cth) (Act);
- (2) considered the specific requirements, if any, to avoid breaching the Act in relation to any benefits to be provided; and
- (3) provided an overview of the types of benefits that we consider would be appropriate in the circumstances that the Board may wish to consider.

APAC-#10820366-v3

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2 Executive summary and recommendation

2.1 In determining the appropriateness of rewards for the Executives, the real question for the Board is whether or not any proposed benefit or change to the benefits is unfair or unconscionable. In making this determination, the Board should have regard to factors including:

- (1) the need to retain the Executives;
- (2) the level of skills and knowledge of the Executives;
- (3) the limitations imposed on other companies by the Act (specifically in relation to termination payments); and
- (4) current market conditions and drivers.

2.2 In circumstances where:

- (1) the proposed new benefits are necessary for the retention of the Executive;
- (2) the retention of the Executive is in the best interests of RQL; and
- (3) the benefits are not disproportionate,

it is unlikely that a resulting agreement would be deemed to be unfair or unconscionable.

2.3 Our suggestions ~~of for~~ appropriate benefits that are not disproportionate, are the most straightforward and that are that would be in the interests of RQL is are as follows:

- (1) an increase to the total remuneration value (TRV) of each Executive of ~~between up to 130% and 20%;~~
- (2) ~~the inclusion of a new 5 year term commencing from, say, August 2014~~ retention of the current 3 year term with an obligation on RQL to renegotiate before 31 December 2012;
- ~~(3) a notice period for termination of the Executive Employment Agreement by either party without cause, which should be an amount (to be decided by the Board and agreed with the Executive) of no more than 12 months;~~
- ~~(4)~~ (3) the implementation of a RQL-wide redundancy policy with payments based on length of service in a particular position; and
- ~~(5) the inclusion of two incentive bonuses as follows:~~
 - ~~(a) a performance bonus linked to the achievement of certain outcomes, with payment of the bonus deferred (say, until half way through the term and then at the end of the term) and conditional on the Executive remaining employed with RQL at that time, unless the Executive's employment is terminated by RQL earlier, in which case the bonus becomes immediately payable; and~~
 - ~~(b) a retention bonus of, say, 12 months of the Executive's TRV, payable on completion of the term by the Executive unless the term is renewed for a further period, or if the Executive's employment is terminated by RQL during the final year without cause;~~
- ~~(6)~~ (4) the inclusion of a material adverse change clause with a trigger that includes a change in State Government, RQL ceasing to be a control body for the purpose of the Racing Act 2002 (Qld), a change to either the make up of the RQL Board, reporting lines for the Executive or an organisational restructure, or a reasonable expectation by the Executive of any of these triggers occurring, entitling Executive to payment of:

- (a) a payment a fixed amount equivalent to the amount of 12 months of each Executive's TRV that they would have received had the Executive remained employed by RQL to the completion of the term, plus an amount of severance pay equivalent to the RQL-wide redundancy pay payment, as a material adverse change severance payment; and
- (b) any accrued incentives (including any deferred incentives); and
- (c) (b) all other legal entitlements (such as accrued leave); and.
- (7) the inclusion of a clause limiting the payments of benefits (as defined in the Act) paid in connection with the termination to the Executive's average annual base salary (as defined in the Act).

- 2.4 In summary, the general effect of these benefits is that in circumstances of a termination or cessation other than for misconduct due to a material adverse change, an Executive would become entitled to resign and trigger a payment equivalent to the amount each Executive would have received to the end of the term and a redundancy payment of up to (depending on the Board's decision about the amount), 12 months TRV. We consider that this will provide the Executives with the protection they are seeking and satisfy RQL's desire to maintain the Executives' employment.

3 Background

General

- 3.1 We are instructed that without implementing a reasonable executive retention strategy, RQL considers it faces a real risk of the resignation of one or more of the Executives. Not only would a resignation of the Executives would have serious implications for the ongoing operations of RQL, but it also places at risk a smooth transition to an alternate structure if one was implemented as a result of a change in the State Government.

Corporate status

- 3.2 RQL is a company incorporated under the Act and limited by guarantee. It does not have share capital.
- 3.3 None of the Executives are currently appointed, or have been appointed in the past 3 years, as a director of RQL.
- 3.4 RQL is not a "disclosing entity" for the purposes of Part 2D.2 of the Act (which relates to termination payments made to person's holding a managerial or executive office).
- 3.5 Under its Constitution, the directors of RQL are required to retire in rotation, two at every Annual General Meeting held in an election year and then every second year thereafter.

Industry environment

- 3.6 We are instructed that the current industry conditions are cause for concern in retaining the Executives.
- 3.7 In particular, there is ongoing industry speculation around the removal of the Board and the termination of the employment of the Executives if there is a change from the current Labor Government to a Liberal National Party (LNP) run Government in the next State election to be held prior to June 2012.
- 3.8 This speculation stems from a number of comments made in Parliament by Shadow Minister for Racing and member of the LNP Mr Ray Stevens MP.
- 3.9 For example, on 20 May 2010, as recorded in Hansard, Mr Stevens stated:

- (1) "We believe that each racing code should have control over its own sector of the industry";
 - (2) "If this bill is passed, we commit to the overall racing industry that this legislation will be dismantled and control will be given back to each of the codes"; and
 - (3) "When the Liberal National Party wins government at the next State election we will immediately dismantle this flawed and undemocratic legislation, and we will put control of the three racing codes back into the hands of the industry participants".
- 3.10 Mr Stevens has also strongly indicated his opposition to the current Chairman of RQL, Mr Bob Bentley, which he has most recently reiterated in Parliament on 25 May 2011.
- 3.11 As part of continued speculation in response to Mr Stevens' statements, on 6 July 2011 the following comments were published on the Letsgohorseracing.com.au website and appear to be indicative of the ongoing speculation in the racing industry:
- (1) "There is also strong speculation that two major roles will change at Racing Queensland under a new Board if the LNP wins Government and these are those of Chief Executive Officer Malcolm Tuttle and Director of Integrity Services Jamie Orchard";
 - (2) "The greatest certainty – according to those who claim to know what the LNP has planned for racing in Queensland – is that Malcolm Tuttle, the one-time steward who made a meteoric rise to CEO under the Bentley-led Board, will be dumped"; and
 - (3) "Malcolm Tuttle and Jeremy [sic] Orchard odds-on to be eventually dumped from their current roles as Chief Executive Officer and Director of Integrity Services."
- 3.12 This speculation is also reflected in the recent comments of made by Mark Oberhardt in the Courier Mail;
- (1) -on 4 July 2011, Mark Oberhardt commented -of "Huge tip that a country racing legend would replace Bob Bentley as RQ Chief if the LNP wins power. And a former race club chairman is tipped as likely new chief executive." and
- 3.12(2) on 18 July 2011, Mark Oberhardt commented "There is continuing speculation about a clean out of racing administrators after the next election."

Executive concerns

- 3.13 As a result of the industry speculation, we are instructed that the Chairman of RQL has received a letter from the Executives dated 5 July 2011 in which the Executives raise concerns in relation to their ongoing engagement with RQL.
- 3.14 Essentially, their concerns are that they face unreasonable risks in relation to their future and are being asked to take a gamble on a reformed company or new RQL Board retaining their services beyond the State election.
- 3.15 The Executives have requested that the Chairman of RQL give urgent consideration to retaining the services of the Executives and put in place a framework that provides them with necessary security.
- 3.16 In our view, the letter from the Executives indicates a real and apparent risk to RQL that it faces early terminations from the Executives should their concerns be ignored.
- 3.17 To add to the Executives concern, each of the Executives is engaged under Executive Employment Agreements having an expiry date of 30 June 2013.
- 3.18 In this context, it would be prudent of any organisation to put in place appropriate measures to ensure the ongoing retention of their senior executives, in our view.

4 Legal obligations

- 4.1 Relevantly, there are a number of legal obligations which have to be considered when determining the appropriate terms and conditions of employment and benefit structure. These are outlined in more detail below.

Common law duty to act in the best interests of RQL

- 4.2 The Board must ensure that any agreement made with the Executives is made in the best interests of RQL.
- 4.3 Further, any agreement that amounts to unconscionable conduct against RQL by the Board carries the risk that it may be set aside by a Court.

Obligation to act in good faith – section 181 of the Act

- 4.4 A director or other officer of a corporation must exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose.

Use of position – Directors, other officers and employees – section 182 of the Act

- 4.5 A director, secretary, other officer or employee of a corporation must not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the corporation.
- 4.6 The directors must, of course, ensure that they are using their powers for a proper purpose. That is, a purpose that is in the best interests of RQL, when determining the appropriate level of remuneration and reward.

Termination benefits to executives – Part 2D.2 of the Act

- 4.7 Part 2D.2 of the Act places a restriction on the benefits that can be paid in connection with the termination of a person holding a managerial or executive office in a company.
- 4.8 Whether a person holds a managerial or executive office depends on whether the company is a disclosing entity. For disclosing entities, this includes a person whose details are included in the directors' report at any time in the 3 years preceding termination.
- 4.9 RQL is not a "disclosing entity" for the purposes of Part 2D.2 of the Act. However, if it was, it is likely that at least some, if not all, of the Executives would be named in the directors' report for the current financial year.
- 4.10 For all other corporate entities, a person holds a managerial or executive office if that person is a director (including "shadow" or "de facto" directors, ie someone with whose wishes the directors are accustomed to acting) of the corporate entity or a person that holds a position in connection with the management of RQL whilst holding an office of director of a related body corporate, at any time in the 3 years preceding the date of loss of that position. As far as we are aware, the Executives are not directors of RQL or any related body corporate.
- 4.11 Accordingly, Part 2D.2 of the Act does not apply to the Executives.
- 4.12 Despite Part 2D.2 of the Act not applying, we consider the Board should take Part 2D.2 of the Act into account in determining the termination benefits to provide to the Executives, because, in our view, ostensible compliance with these provisions would provide RQL with a defensible position that the termination benefits are reasonable and in the best interests of RQL.
- 4.13 Essentially, Part 2D.2 of the Act provides that benefits paid in connection with the termination cannot be made without shareholder approval unless the benefits do not exceed the amount set out in the formula contained in the Act (Cap):

- 4.14 The Cap varies depending on the length of time that the relevant executive has held a relevant office. If the office has been held for more than 3 years, the value of the benefits must not exceed the amount equal to the average annual base salary that the person received during the last 3 years of the relevant period (with the "relevant period" being the period or combined periods in which the person has held the position).

5 Relevant current arrangements

- 5.1 The Executive Employment Agreements all commenced on 1 July 2010 and have an expiry of 30 June 2013, unless terminated earlier in accordance with its terms.
- 5.2 Clause 15 of each Executive Employment Agreement provides for termination by RQL without cause by giving six weeks notice and paying the TRV the Executive would have received for the balance of the term.
- 5.3 Prior to 1 July 2012, RQL has an obligation to negotiate any extension to the employment contract beyond 30 June 2013.

6 Possible options

Change to remuneration

- 6.1 The industry speculation in relation to the ongoing engagement of the Executives would, in our view, justify an increase to the Executive's remuneration to partially address the Executive's concerns.
- 6.2 In determining what might be an appropriate increase it would be beneficial to have regard to comparable market rates to offer a package that will be attractive to the Executives while ensuring that it is reasonable having regard to each of their positions.
- 6.3 This information can be obtained by the engagement of a remuneration consultant. We can assist you in identifying an appropriate provider if you wish. We have, however, reviewed the Ernst & Young Remuneration Practices in 2010 and 2011 report which analyses the ASX 200 companies' remuneration practices (EY Report) to gauge current conditions. It remains to be seen whether a comparison between RQL and the information in the EY Report is appropriate, because we have not performed any comparison between RQL and ASX 200 companies to determine whether there are any common characteristics. The key highlights of this report however are that fixed remuneration increases will be constrained in the current year with a greater focus on performance-based pay.
- 6.4 In our view and taking into account the need to retain the Executives, we would consider an moderate increase to the Executive's remuneration of between up to 340% and 20% would be reasonable in the circumstances. This is the most straightforward way to address the retention concerns. We discuss other options below. If other retention options are implemented (such as the incentive plans) a lesser increase to remuneration should be considered. However, the precise increase depends whether other options are implemented by the Board.
- 6.5 We consider that it is in the interests of RQL to maintain a moderate increase to each of the Executive's TRV whilst placing greater protection around longevity by implementing the retention options discussed below.

Incentive plans

- 6.6.5 Under the Executive Employment Agreements there is currently no entitlement to a short or long term incentive.
- 6.6 In our view, it would be reasonable for RQL to put in place a short term incentive plan.
- 6.7 We consider that this plan should could have two limbs:

- (1) a performance bonus linked to the achievement of certain outcomes, with payment of the bonus deferred (say, until half-way through the term and then at the end of the term) and

conditional on the Executive remaining employed with RQL at that time, unless the Executive's employment is terminated by RQL earlier, in which case the bonus becomes immediately payable; and

- (2) a retention bonus of, say, up to 12 months of the Executive's TRV, payable on completion of the term by the Executive unless the term is renewed for a further period, or if the Executive's employment is terminated by RQL during the final year without cause.

6.76.8 We recommend that the deferred bonus plan is determined having regard to comparable plans in the market. Relevantly, bonuses or incentives determined by the achievement of measurable targets are not included in the calculation of "benefits" for the purpose of the Cap.

6.86.9 The retention bonus, on the other hand, would be considered as a "benefit" for the purpose of the Cap as it is payable in connection with termination or cessation. However, in this case the other benefits such as payment in lieu of notice, redundancy, or payment on the occurrence of a material adverse change would not apply.

6.10 In our view however, if RQL was to incorporate an incentive plan into the Executive's remuneration, a more moderate increase to remuneration (10% to 20%) should be considered.

Notice of termination without cause

6.106.11 Clause 15 of each Executive Employment Agreement currently provides for termination by RQL without cause by paying the TRV the Executive would have received for the balance of the term.

~~6.12 We set out below our suggestion to increase the term to 5 years. On this basis, it is then a matter of striking a balance between an excessive payment and a reasonable one.~~

6.12 RQL could consider increasing the notice required on termination without cause. In the normal course, we would suggest that a notice period of up to 12 months would be reasonable depending on the seniority of the Executives. That amount would be reduced pro-rata if notice of termination is given in the final year of the term, but in that case, the retention bonus would be payable.

6.13 If there is an increase in this way to the notice period, the Board should consider restricting the increase to remuneration we have recommended (up to 30% of each Executive's TRV) to a more moderate amount (10% to 20%).

6.12 As notice of termination is taken into account in the calculation of termination payments under the Act, it would be appropriate here to limit the amount to that which would not breach the Act. Under the Act, the actual period of notice should not, when combined with the value of all other termination benefits, exceed the Cap. Any amount higher than this could be viewed as being inconsistent with the duties the Board owes to RQL under the Act.

~~6.14 So in the normal course, we would suggest that a notice period of up to 12 months would be reasonable depending on the seniority of the Executives. That amount would be reduced pro-rata if notice of termination is given in the final year of the term, but in that case, the retention payment would be payable. For that reason, we recommend setting the retention payment at the same amount as the notice period.~~

Redundancy payments

6.14 Currently, there is no contractual entitlement to a payment on termination of employment due to redundancy.

6.15 We are also not aware of any policies applicable to the Executives of other employees of RQL that contain redundancy entitlements.

6.16 Under the Act, where there is a genuine redundancy a reasonable payment that is made in accordance with a policy that applies to all employees of RQL on the basis of a person's service in

an office or position is not a "benefit" under the Act, and is therefore not taken into account for the purposes of the Cap.

6.16

6.17 In line with the requirements for redundancy under the *Fair Work Act 2009* (Cth) (**FW Act**), we consider it appropriate for RQL to implement a redundancy policy that applies to all of its employees with payments determined on the person's length of service with RQL.

6.18 You should note that the introduction of an RQL-wide redundancy policy would result in a cost impost on RQL in the event RQL decides to make any employee redundant. This is because for some employees, the current redundancy requirements contained in the FW Act are lower.

6.19 However:

(1) the reason for implementing an RQL-wide redundancy policy is to increase the defensibility of a severance payment made to the Executive on termination of employment, equivalent to redundancy, on the basis that the redundancy component is no more than what other employees would receive; and

(2) the introduction of a RQL-wide policy in this way reflects current employment practices.

6.18 Of course, this policy would not apply if the Executive's employment ended at the completion of the term, but it provides further comfort in the event of a restructure or a cessation of operations.

Material adverse change clause

6.196.20 An option available to RQL is the inclusion of a material adverse change clause. Under a material adverse change clause the Executive will be able to terminate the employment agreement on the trigger of a material adverse change and receive a payment. Examples of material adverse changes could include a change in State Government, RQL ceasing to be a control body for the purpose of the *Racing Act 2002* (Qld), or a change in either the make up of the RQL Board, reporting lines for the Executive or an organisational restructure.

6.206.21 If there is a material adverse change, the Executive has the right to resign and if he or she does so, he or she will be entitled to payment of a sum calculated in accordance with a specified calculation. The payment would be a fixed payment of, say, no more than 12 months an amount equivalent to what the Executive would have received if they had remained employed by RQL for the balance of the term of the Executive Employment Agreement, plus a severance payment equivalent to redundancy.

6.22 You should note that, in our view, the Australian Taxation Office (ATO) will treat an amount paid as a result of a material adverse change in these circumstances as an employment termination payment as opposed to a genuine redundancy payment. This is because there has been no "dismissal" at the initiative of RQL.

6.216.23 As an additional protection for RQL, we recommend making the payment conditional upon the execution of a deed of release, and a commitment for the Executive to serve a short transition period unless otherwise agreed.

Extension to term

6.226.24 Any variation to the terms of the Executive Employment Agreements will provide RQL with an opportunity to extend the term of each Executive's engagement.

6.236.25 One option would be for RQL to offer the Executives permanent employment (subject to notice). Permanent employment, combined with the 12 months notice of termination, would in our view ensure the ongoing employment of the Executives and allow for a smooth transition resulting from any change to RQL's structure.

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6.246.26 However, it is more likely that the offer of permanent employment or any extension to the term would attract a higher level of public scrutiny and criticism. While we consider that your position would be defensible from a legal perspective, you may like to consider a more conservative approach in order to minimise the possible negative publicity.

6.256.27 As an alternative, and taking into account our suggestion on an increase to each Executive's TRV, maintaining the term as it currently is with an expiry of 30 June 2013 will minimise the risk of public criticism.

6.28 We recommend however amending the time by which RQL is required to renegotiate any extension to the contract (which is currently before 30 June 2012) to require renegotiation before 31 December 2012. Given the timing of the State election by no later than June 2012, the future of the Executives will be more certain at that time.

6.26 you could offer an extension to the current term of the Executive's engagement of a new 3 year term (eg from August 2011 to August 2014). In our view however, it would be reasonable in the circumstances (especially if the other benefits set out above are adopted) to adopt a 5 year term (subject to notice as discussed above at paragraph 6.13). Our view has regard to our general understanding that 5 year terms (terminable on 12 months notice) are not uncommon for executives in local government, State government or quasi-government bodies.

Please let me know if you have any queries. Alternatively, please contact Kristin Gamble on (07) 3414 2876.

Yours faithfully

Murray Procter
Partner
Norton Rose Australia
Contact: Kristin Gamble

