
DISCUSSION PAPER ON SITE PAYMENTS

Introduction

The Department is reviewing the policy and licence conditions relating to the payments societies make to the businesses at which their machines are operated. We are seeking your input to this review.

This paper is intended to provide a basis for consultation with gaming machine societies, sector interests and community group. In this paper, we set out the background, issues and options as we see them.

We ask that you make submissions in response to this paper, in whatever form is most suitable to you, no later than 20 June 2003. We will analyse and summarise the submissions, send out a further discussion paper with recommendations included and then arrange meetings as appropriate.

Submissions can be sent to:

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If you have any queries about this paper or the consultation process, please phone Kate Reid on 04 494 0674.

Goals

The Department wants to achieve the following things as a result of this review:

- Societies returning the maximum possible amount of benefit to the community by:
 - maximising return to authorised purposes;
 - minimising expenses;
 - reducing the incidence of harm caused by gaming machine use.
- Gaming machines being operated on a non-commercial basis, that is,
 - no personal benefit or commercial profits for licensees or their agents;
 - site operators may be reimbursed for actual, reasonable and necessary costs incurred in operating the gaming machines, but must not make profit from that activity.
- The elimination of possible “bidding wars” for sites, which are driven by commercial interests and detract from the ability of societies to maximise returns to the community.
- A fair, effective and workable regime that provides clarity and certainty for all concerned and does not impose unrealistic requirements on any party.

Background

Prior to July 1997, the payments societies made to site operators were limited to specified amounts and categories of expenses (eg. \$60 pmpw site rental and \$3 pmpw electricity).

After the 1996/97 review of the licensing regime, the Department amended its regulatory approach. The limits on expenses were removed and societies were required to restrict expenses to those that were lawful and necessary for the societies' gaming machine operation. Societies were also required to return at least 33% of gaming machine profit to authorised purposes.

In late 2000, the Department undertook research that showed that societies were making payments ranging between \$0 and \$250 pmpw. Although the Department expressed concern about payments reaching \$250, some societies continued to escalate the payments made. In the interests of assisting societies, the Department published a guideline on reasonable site expenses in June 2001. However, there appeared to be no reduction in the "bidding war" for sites, based on a market approach to prices rather than reimbursement of lawful and necessary site expenses.

As a result, the Department took the view that the licence conditions should be amended to control the payments to site operators. The Department proposed that payments to site operators be capped at a realistic level. Based on the information provided by societies, the Department assessed that at least 70% of sites were being paid less than \$150 pmpw. In view of this, the Department set the standard limit on site payments to \$150 pmpw, but allowed for societies to make applications for dispensation to make higher payments.

Initially, the onus was on societies to make a business case for each situation. However, societies sought detailed criteria from the Department. Between November 2001 and January 2002, the Department consulted with societies on proposed criteria and, in January 2002, published the criteria by which it would make dispensation decisions. Under the criteria, sites were not entitled to a dispensation unless they generated at least \$1M in annual gaming machine profit, or the proportionate equivalent over a 12 week period, to be entitled to a dispensation. The criteria set out 5 steps relating gaming machine profit to maximum site payments. Between January 2002 and February 2003, the Department approved 257 of the 285 applications received.

Recent Events

In September 2002, a multi-site trust filed judicial review proceedings in relation to the Department's decision to decline 3 applications where the gaming machine profit did not meet the minimum criteria for eligibility for dispensations. Those proceedings were heard in the Wellington High Court in March 2003 and the judgment of Durie J. was issued that same month. (A copy of the decision in *Pub Charity v Attorney-General* is available on the Department's website at www.dia.govt.nz).

The Court found that the Department's criteria for determining dispensation applications were unlawful and it quashed the Department's decisions in relation to the 3 dispensation applications. The Court found that the Department had limited its consideration of the applications by applying restrictive criteria rather than assessing the actual, reasonable and necessary expenses claimed in each case.

The Court also found that payments made in accordance with the criteria amounted to commission payments (in terms of s8(2) of the Gaming and Lotteries Act 1977) and were therefore illegal.

As a result of the High Court judgment, the Department's decisions on all dispensation applications are unlawful. The Department must remake all of these decisions. The Department has decided that it is, therefore, sensible and necessary to review its policy and licence conditions on site payments. In undertaking this review, the Department is consulting with societies and community interests.

Options

The options discussed below have been drafted with the following assumptions:

- The licence condition regime under the Gaming and Lotteries Act 1977 will continue to operate for up to another 12 months.
- The Department will continue to set limits on the payments societies may make to site operators because the legislation mandates that societies must operate gaming machines solely for the purpose of raising funds for the benefit of the community.
- The principle that will inform and direct any future regulations, licence conditions or rules is that societies may pay only expenses that are **actual, reasonable and necessary** if they are to comply with the legislative objective of prohibiting the conduct of non-casino gaming machines for commercial gain. Actual, reasonable and necessary payments will not include any form of payment related to the "value of the site to the society" or other payment that approximates profit or commercial return.
- The proposed regulatory regime under the Responsible Gambling Bill will require societies to minimise expenses and maximise return to authorised purposes.
- No payments can be made on a commission basis.

Within the ambit of the Department's intention to regulate for the lowest cost, highest return to the community, there are a number of ways to control site payments.

1 No specific limits

A) We could revert to the approach taken between 1997 and 2000. This approach would require the removal of the standard limit, but all site payments would be subject to Departmental scrutiny and would be tested against "actual, reasonable and necessary" criteria. This might lead to greater uncertainty in the sector, as the validity of payments may always be open to challenge by the Department.

B) We could remove the standard limit and require all payments to be pre-approved by the Department. This has the advantage of providing responsiveness and certainty, but the disadvantage of being extremely time consuming and involve considerable work for societies and the Department.

2 *Limits with dispensations*

A) We could continue the present system of a \$150 standard limit with dispensations, although the criteria for assessing dispensation applications would have to be revised. This has the advantage that societies fully understand this approach, but the disadvantage that the approval of dispensations could be time consuming.

B) We could continue as in 2A, but set the standard limit at some other level than \$150. This has the same advantages/disadvantages as 2A.

3 *Limits with no dispensations*

We could retain a standard limit without dispensations. This has the advantage of simplicity, but may disadvantage site operators whose genuine costs exceed the standard limit, or disadvantage the community where site operators' costs are lower than the amount paid.

4 *Limits for various components of site payments/dispensations for specific components if necessary*

We could set a range of limits for some, or all, components of site costs on an item by item basis. This approach could fit within an overall standard limit, or could be used to set limits in individual cases, depending on the items claimed. Dispensations could be claimed for specific items. This may provide a more flexible approach that may also be relatively simple to manage.

5 *Remove the "per machine per week" approach*

In any of the above options, we could remove the requirement for site payments to be expressed in terms of "per machine per week" and simply require the costs claimed to be stated in plain terms.

Q. Can you identify any other options?

Q. Do you favour any of the options set out above? Why?

Q. Can you identify any other advantages/disadvantages?

Q. If a dispensation option is chosen, what criteria do you consider would be appropriate?

Issues

Within all of the above options, there are a number of common issues to be considered:

- What costs are "reasonable and necessary"?
- How will the society and Department assess the claimed costs?
- How frequently should approved costs be reviewed?

Reasonable and necessary costs

Since July 1997, the Department has accepted that the society should reimburse the site operator for the reasonable and necessary costs actually incurred in operating the society's machines. This approach can be justified on the grounds that it is unfair and unreasonable for a society to expect the site operator to pay some or all of the costs of operating the society's gaming machines.

Labour costs

Clearly, the direct costs incurred by the site operator must include the cost of the labour expended in performing the duties that the society requires the site operator to carry out. The range of such duties may vary depending on what the society negotiates into the applicable site agreement, but the core duties are usually fairly consistent across most sites and societies. The time required for each duty can be measured and the frequency of many duties can be verified from the gaming machine records.

Suitably trained front line staff will carry out most routine duties. However, it may be reasonable for a site manager to be responsible for duties where there is high risk to the integrity of the gaming operation, such as paying out major prizes or reconciling the banking.

The typical range of duties the society requires the site operator to carry out include:

- start-up/close down GMs
- hopper refills
- cancelled credit payments
- clearing coin jams
- clearing cash
- meter readings
- jackpot recording, reconciliation and payments
- preparing WGMPR
- preparing MMA (or Cashless equivalent)
- banking GM profit
- resolving player disputes & other problems
- liaison with society
- liaison with GM service provider
- reconciling float
- training on GM operations

Not all site operators are required to perform all of these duties. Clearly, site operators cannot be paid for duties carried out by other service providers. Each duty claimed for must be justified by a provision in the site agreement. The total amount of time will largely depend on the number of GMs on site. In the past, it has been estimated that up to 3 hrs/wk/GM is reasonable for basic duties.

Q. What do you regard as typical direct labour costs?

Q. What duties is it necessary that a manager undertake and why?

Q. What do you consider would justify higher than typical labour costs being reimbursed?

Other direct costs

Gaming machines consume electricity and the money in them has to be insured. These are costs that are generally claimed and accepted. There are costs incurred in undertaking eftpos transactions. Some administrative and cleaning costs may be acceptable, as records need to be kept, phone calls made and the machines kept clean. In addition, some security related costs are likely to be justifiable.

The general principle in relation to these costs, as with labour costs, is that the site operator must be able to prove to the society that the costs were actually incurred and were reasonable and necessary to the gaming operation. These costs should not include items that relate to the installation of the gaming machines or to other costs that properly are for the society itself to pay. Nor should the general costs of the site operator's business be a factor, directly or indirectly, in the costs claimed. Invoices, bank statements and fully compliant gaming records should provide the detailed evidence to substantiate any claim.

Typical non-labour direct costs include:

- *Electricity.* A typical GM uses an average of 400 watts of energy. A reasonable cost of electricity is, therefore, about \$3 pmpw, although this may be increased marginally when other equipment directly involved in the gaming operation is included.
- *Insurance.* The site operator should carry insurance cover for the cash held on site for the GM operation, usually equates to the amount of the GM float.
- *Interest.* Some sites claim the loss of interest on the value of the float as a site expense. The amount of the float should be reasonable, as should the interest rate.
- *Bank fees.* Many sites claim fees on eftpos transactions, where players use eftpos to draw out cash to play GMs. Where this cost is strictly limited to gaming activity transactions it may be justified, but the cost of eftpos equipment and dedicated phone lines are not justifiable costs. The only other bank fees that appear to be relevant are those arising from the site operator's float maintenance.
- *Security.* Societies have varying requirements. Some insist on high levels of security, including safes, cameras, security patrols, alarm systems or frequent cash clearance and banking. It does not seem reasonable that the society pay the total cost of security for the whole site.
- *Miscellaneous.* Societies agree to pay for a variety of minor expenses, including, phone rental, stationery, photocopying, postage, and computers. These items may be acceptable, but it is a matter of degree and evidence. Often these items are for small amounts, but they can tend to inflate the overall site expenses figure unnecessarily.

While such costs are separated into categories, it is possible that one or more costs are to some extent offset by other factors. For example, the interest a site operator earns on the gaming machine funds before banking them into the society's account may be more than enough to offset the relevant bank fees. Use of electronic systems for records or in cashless operations should provide some offset to usual labour costs.

Q. What do you regard as typical direct costs, other than labour?

Q. What do you consider would justify higher than typical costs being reimbursed?

Site Rental/Floor Rental

The term “site rental” has had a varied history in this context. Originally, it was used to refer to the principal regular payment the society made to the site operator. It was regarded as the payment for the space occupied by the machines on the site. From July 1997, the term was defined as the payment for the rent of the floor space only. In October 2000, the term was redefined as the payment for the use of the premises for operating the gaming machines and in February 2002, redefined again as the value the society placed on the site as a generator of gaming machine profit. This last redefinition was made at the same time that the criteria for dispensations were published.

Following the recent High Court decision, no payment can be linked in any way to gaming machine profit or turnover, and payments can only be actual, reasonable and necessary. This means that site rental cannot lawfully be based in any practical way on the value of the site to the society as a generator of funds. In view of this, it appears that the only practical basis for site rental is for it to be payment to reimburse the site operator for the cost of floor rental of the space that the society requires at the site.

Whether it is reasonable for the society to reimburse the site operator for the use of the space occupied by its gaming machines at a site is debatable. While it is true that the site operator is making space available to the society, the site operator incurs the cost of that space whether or not gaming machines are present.

Floor space could be calculated by assessing the floor space required for safe operation of the machines, or by the society specifying the space it required for its machines to be operated in. If the latter approach were used, the society would have to fully justify the amount of space on a case by case basis. One way of assessing floor rental is to take the same proportion of the cost of the lease, or an independent rental valuation, as the floor space used by the society is of the total floor space of the site.

Q. Do you believe that the society should pay for floor space occupied by gaming machines?

Q. What do you regard as the proper basis for this?

Q. How do you think floor rental should be calculated?

How should costs be assessed?

Under the options stated above, the society should obtain current and complete documentation from the site operator to support any claims made. That documentation would be necessary to prove to the Department that the site payments are justified.

For sites without a track record in operating gaming machines with a particular society, there will be an initial period in which the actual costs of operating the gaming machines will have to be assessed. As a practical matter, it may be necessary for the society to negotiate some form of interim payment to cover the assessment period.

Under the Gaming and Lotteries Act, the Department has wide powers to obtain information and these are given expression in the current licence conditions. However, under the proposed legislation, the Department's powers to obtain information may be broader, for example, the Bill proposes to give the Department the power to audit venue businesses.

Q. What information do you think the society and Department should rely on in assessing site payments?

Q. What should be done for the interim period when a new site starts up or a site moves between societies?

How frequently should approved costs be reviewed?

The Department believes that the costs claimed by site operators should be periodically reassessed by the society, probably on an annual basis. This requirement should be stated in the site agreement between the society and the site operator.

If a dispensation option is part of the selected regime, the Department is likely to require the term of the dispensation to match the term of the society's licence. Dispensations would be renewed with the licence, provided that a current, fully documented, case is made for each dispensation. Applications for dispensations during the term of the society's licence would be in the form of a licence amendment application, with the applicable fee payable.

Q. Do you agree with this approach?

Q. How often should costs and dispensations be reassessed?