



Proposal for a smooth transition for clubs to the 2012 gaming licence regime

ClubsVIC welcomes the announcement of the new post 2012 regime for the distribution and operation of gaming machines in Victoria.

It is acknowledged that the government's objective is to provide a fair system whereby all those clubs which aspire to have gaming machines have equal opportunity to bid for the chance to do so. Also, it is acknowledged that the government is sincere in its stated objective to provide for the not-for-profit community sector by maintaining the 50:50 ratio between pub and club machines and by discouraging outcomes that would disadvantage true community, grass-roots clubs in favour of well-funded elite sports clubs, pseudo clubs, and hotels.

ClubsVIC is determined to work with the government to ensure that the introduction of the new system is as seamless as possible and that the government's objective is met. To this end, we have consulted with the club membership and have identified a number of unfortunate, unintended consequences of the new system. We have also identified means by which these consequences can be avoided. It is the purpose of this paper to set out the "challenges" and to suggest "solutions".

In the "Challenges" section below some examples are given of how the system may result in unintended consequences. In the "solution" section we set out ClubsVIC's suggested means of avoiding these unintended consequences.

THE CHALLENGES

Pseudo Clubs

The Carlton Wine Society Inc is formed today. It is a bona fide local community club. It consists of 20 friends who enjoy wine and who see the opportunity that the new system provides. While the club is controlled by the 20 friends, the committee signs binding agreements with a company controlled by the committee. The terms of the

agreements provide that in the event of the club acquiring gaming machines in the auction, the club will engage the company to provide management services and enter into a lease of the company's property for the period of the entitlements. The club applies for and gets a venue operators licence (VOL).

The agreements bind any future committee. If the Carlton Wine Society Inc is a successful bidder, the company is the beneficiary of the revenue of the gaming machines, at the expense of another true Carlton community club which currently has machines, and which was outbid for entitlements in the auction and lost its allocation of machines.

The requirement to have only a VOL (and not approved premises) will advantage management companies set up specifically to take advantage of the new regime as in the case of the Carlton Wine Society, current hotel operators and management companies which already hold VOLs, and are familiar with the phenomenon of managed clubs.

Exploitation of Clubs

Instead of a new club being formed, an opportunist may approach an existing club, eg the Carlton Tennis Club Inc and arrange for the Carlton Tennis Club Inc to acquire a VOL and enter into an agreement with company X to do all things necessary for Carlton Tennis Club Inc to bid for gaming machines. In return for the Carlton Tennis Club Inc receiving, say \$50,000 a year if it is a successful bidder, the club enters into an agreement with company X to provide management services and leased premises to the Carlton Tennis Club Inc at, say \$500,000 per year.

Again, the agreements bind any future committee of the Carlton Tennis Club Inc, and the company (which may already hold a VOL) receives the vast majority of the revenue from the gaming machines. Again, another true Carlton community club which currently has machines, and which was outbid for entitlements in the auction will lose its allocation in favour Carlton Tennis Club Inc and company X.

Cannibalisation within club sector

A country town may currently have 2 viable clubs – one with 50 machines, which is more successful than the other that has 30 machines. The 50 machine golf club outbids the smaller bowls club and successfully bids for all 80 machines.

The economies of scale are then applied, and where before there were 100 people employed across both clubs, now there will be 75 people employed, one baker where there was two, one fishmonger, one butcher. The bowlers are disadvantaged in favour of the golfers.

An even more undesirable outcome is that well-funded elite sports clubs, or well-managed pseudo clubs buy up all the club allocations in areas at the expense of local community clubs. In this event, the local grass-roots community from where the gaming

revenue is raised is disadvantaged as the vast majority of the revenue is diverted away from the local sports club which was outbid in favour of a “foreign” elite club.¹

As well, it is highly likely that clubs will attempt to “take-out” the competition by buying up as many entitlements as possible. The buying club may not intend to utilise the entitlements, but simply render the competition uncompetitive by taking all or most of its machines. The club can then sell the entitlements (maybe after the moratorium) on the condition that they are utilised in some other area – leaving the club with a virtual monopoly.

Maintaining a club footprint in capped areas

Clearly, it is likely that, without manipulation of the market, clubs will be totally outbid in more lucrative capped areas. The entire postcode allocation could conceivably be taken up by the hotels in the area, leaving no allocation for clubs in these areas. It is speculative at best to rely on clubs in other areas taking up the unmet club allocation from these capped postcodes – at worst it is encouraging the activity described above.

Councils disallowing utilisation of entitlements

In view of the anti-gaming machine policy adopted by most municipal councils, it is possible that local councils will thwart the utilisation of entitlements by successful bidders. If current regulations remain, new entrants will face long and expensive legal battles to have premises approved. Entitlements will remain unutilised while VCAT applications are determined. This will result in loss of revenue (for government and for the local clubs), unexpected costs for the clubs at the expense of the local purposes to which this money would otherwise be put, and it will also encourage an “aftermarket” in entitlements. As the legal process soaks up available finance, clubs will be forced to sell the entitlements rather than utilise them – a phenomenon that will encourage the opportunist behaviour explained above.

Valuing entitlements

There is much uncertainty surrounding the auction process, including the cost of the entitlements, the tax structure, the process for funding the entitlements, the means of distributing machines amongst the “lesser” bidders etc. Although hotel owners are able to react quickly to changed circumstances and knowledge, this is not how clubs work. Club decisions are made by committees and members. The limits on the powers of committees restrict their ability to respond quickly, especially when the situation involves a long term financial commitment by the club.

¹ The current phenomenon of requiring “foreign” clubs to contribute some of their revenue to local clubs goes only a very small way to address this situation. For instance, one club is required to donate \$140,000 to local sports clubs. The reality is that community is contributing many times more than \$140,000 to a foreign well-funded elite sports club.

Many clubs may need to get approval of an annual general meeting in order to commit to entering into long term financial arrangements for the purchase of entitlements and machines. And changed circumstances, e.g. a higher price than anticipated for entitlements, or a lesser number, may require the club to go back to the members. There is a very real potential for inertia as volunteer committee people refuse to make on-the-spot decisions that may expose them to criticism at best and legal liability at worst.

True, community clubs are not made for independent, quick action. It is acknowledged that education in the bidding process will be available, however, that does not address the issue of valuing the entitlement and reacting to changed circumstances during the lead up to the auction and the actual auction.

Financial uncertainty between now and the auction, and post 2012

Many clubs are facing financial uncertainty now.

The mere announcement of the new regime is sufficiently significant to put current financial arrangements in jeopardy. Although it is unlikely, banks would be at liberty to call in loans that outlive 2012 based on the announcement alone. It is more likely that these loans will become repayable if and when the club is unsuccessful in its bid, or the bidding process impacts adversely on the club's financial situation.

It is acknowledged that there was no guarantee past 2012. However, clubs were forced to enter into long term financial arrangements if they were to continue to operate up to 2012. However, smoking regulations required renovations; operators required expenditure in order to ensure renewal of contracts; long term financial arrangements and leases fell due and required renewal. Many clubs will be required to renew leases and financial arrangements prior to the auction. ClubsVIC is currently assisting two clubs that are in this situation.

The reality is that clubs had to continue to operate, and it is now incumbent on the government to respond sensitively to the reality of the situation. Club members expect the government to work with them to address this difficult situation. They do not expect the government to exacerbate their difficulties by ignoring the realities.

There are many more people affected adversely if clubs go under, than are affected by a downgrading of the operators' share price. Local people employed by the clubs, local businesses which supply the clubs, local sports teams supported by the clubs, local contractors that service the clubs, local financiers who finance the clubs – all these people are currently in jeopardy of disadvantage and disaffection by the uncertainty and will be adversely affected by a sudden dislocation.

The Ansett workers have probably now all recovered from the disruption of the airline's failure. However, it is expected that the government would want to avoid a similar violent dislocation, especially in the community not-for-profit sector, when a smooth transition is achievable.

THE SOLUTIONS

Approval of premises

Apparently, it will be necessary to have VOL in order to register to bid for gaming entitlements, but not necessary to have approved premises in order to bid.

ClubsVIC considers that it should be necessary to have approved premises in order to register to bid for entitlements. Further, it should also be necessary to have approval for the premises to house a certain number of gaming machines, which number is to be the maximum number for which the club may bid for those premises.

If clubs are required to have approved premises for specific numbers of machines many of the challenges will be addressed.

Clubs will be required to submit to the processes of applying for premises approval and will be better informed of the imposts of establishing a gaming venue prior to bidding. This will discourage ambitious bidders who are unaware of the effort and cost of obtaining premises approval. It will discourage the establishment of an aftermarket for unutilised entitlements bought by clubs which cannot obtain premises approval due to lack of funds or hostile councils.

There may be a requirement to better resource the VCGR in order to ensure timely processing of applications. It will also be necessary to allow for premises approval to be provided on the condition that the approval is to operate post 2012, and that the number of machines in the area does not exceed the cap or 10 per 1000 adults (whichever applies). Further, councils should not be at liberty to object to the approval of premises if the number of machines in the area does not exceed the cap or 10 per 1000 adults.

Local/community bona fides

Registrants to bid for club entitlements should be required to prove that they are a local club or be an incumbent. This should require more than a token payment to local community organisations. There should be a real relationship between the bidding club and the local community.

ClubsVIC considers that it is appropriate to require that registrants prove that the club was in existence in the area prior to the announcement on 10 April 2008. This will discourage opportunist behaviour and encourage registration by true grass roots clubs.

Financial viability

Registrants who bid for club machines should be required to produce documentation that evidences a realistic assessment of the financial viability of the club's prospects to operate gaming machines.

Bidders for **club** machines will not be bidding for their own future wealth, but to increase the value of a community asset. In effect the current committees are the custodians of public assets. The risk they take in bidding impacts on the community, not on their own financial situation. By winning a bid, the successful club denies another community organisation the right to the revenue of those machines. Hence, clubs should be required to attest that they have considered the financial viability of the operation.

Corporate Governance

Operating gaming machines is a privilege, and clubs that are afforded that privilege should be required to attest to their understanding and commitment to proper corporate governance. Bidders for club machines should be required to subscribe to a recognised corporate governance regime which includes education of all committee people in the principles of good corporate governance and regulatory compliance.

Avoiding concentration of control of club machines

ClubsVIC is curious that the government has not placed restrictions on the number of venues and club machines that can be controlled by one organisation or group.

It has long been a concern within the club sector that the tendency towards concentration of control of club machines will mimic the experience in the hotel sector. Prevention is better than cure, and ClubsVIC highly recommends that the government place restrictions on ownership prior to concentration becoming a reality in the not-for-profit sector.

It is submitted that the restrictions required in the club sector should be far less than the 35% announced for the hotel sector. ClubsVIC current policy is that no one organisation or management group should control more than 300 club machines and no more than 4 club venues.

Exemption from collusion

ClubsVIC and its member clubs will need to work together if they are to collate and disseminate the information required to prepare for, and to bid at, the auction. It is imperative that clubs are not subject to the usual prohibition on collusion during this first transitional period towards the new system.

ClubsVIC submits that clubs should be exempt from liability under the Trades Practices Act and the Collusive Practices Act for the auction.

Guaranteed Minimum Entitlements for Pre-commitment machines in existing clubs – the overall solution

In 2010 all new machines will be required to accommodate pre-commitment by the player. Details of the pre-commitment are yet to be finalised, and it is not known if current stock of machines will be able to be retro-fitted with the necessary mechanisms

to allow for pre-commitment as envisaged by the Premier in his announcement. We do know that neither operators will replace existing machines between now and 2012. hence there will be no pre-commitment machines at the end of the current operators' licences.

It is to be expected that clubs will be reluctant to proceed to the pre-commitment facility. Firstly, new machines will be expensive and any upgrade will incur the provision of pre-commitment. It does not bode well for the future to have a club sector with out-dated machines that do not meet harm minimisation standards.

ClubsVIC proposes that the government can address the reluctance of clubs to upgrade, and can address all the challenges of the transition to the new regime, by adopting the *Minimum Entitlement for Pre-Commitment* proposal.

In essence the proposal is that a proportion of 13,750 club entitlements be set aside prior to the auction date – the sooner the better. The number that is set aside should be such that allows for the anticipated unmet demand to be met at the auction.

The number of entitlements that is set aside should be allocated equally amongst the incumbent clubs (there are 269 club venues and 2 hybrids). Each incumbent club should then be at liberty to purchase its pre-auction allocation at a set price prior to the auction. If the allocation is more than the club's current quota of machines, then the club's pre-auction allocation will be the current number.

If a club does not take up its pre-auction allocation, then those entitlements will be placed in the auction allocation.

Clubs will be at liberty to bid for more entitlements than their pre-auction allocation during the auction.

It should be a condition of taking up a pre-auction allocation that the club agrees to have the pre-auction allocation meet the pre-commitment requirements by 2015 – ie clubs must commit to up-grading at least the number of pre-auction machines within 3 years.

The *Minimum Entitlement for Pre-Commitment* proposal meets the government's harm minimisation objectives and allows a smooth transition to the new competitive regime. It provides for a guaranteed club footprint in the capped areas, it provides some protection from opportunists and cannibalising clubs, it allows certainty between now and the auction process and it ensures that there is a sufficient pool of club entitlements to meet unmet demand.

The *Minimum Entitlement for Pre-Commitment* proposal received unanimous support at a recent general meeting of clubs with gaming machines attended by more than 360 club representatives. The proposal has been discussed with the senior RSL personnel who are obliged to have any such proposal approved by the decision making processes of the RSLs, and so could give no official indication of the organisation's attitude to the proposal. Regardless of the RSL's response to the proposal, ClubsVIC members are

very happy to meet the pre-commitment requirement in return for the minimum entitlements and would be very happy to take up the entitlements that would otherwise be available to RSL clubs.

OTHER ISSUES

Bidding period

Clubs are concerned that the bidding period will be too short. One day does not allow for the nature of club decision making. Neither does it allow for a computer hitch, a sickness or accident on the day, or the myriad of things that can go wrong.

Prohibition on assignable management agreements

ClubsVIC accepts that clubs should be at liberty to engage professional management, either on an employment or contractual arrangement. However, ClubsVIC submits that management agreements between clubs and managers (either individuals or companies) should be determinable by the club for non-performance, should not be tied to tenure of property (ie any attempt to determine the management agreement results in determination of a lease) and should not be assignable by the manager (ie management agreements should not be assignable property).

Vesting of rights in licensee

The right to the entitlements should vest in the licensee club and NOT in the property or landlord. Clubs entitlements should be freely transferable and agreements that vest club machines in private landlords should be prohibited.

Abolition of 5/10 Kilometer rule

Authorised gaming visitors to clubs should not be required to reside 5 or 10 kilometers from the club premises.

Taxation

ClubsVIC would recommend that the system for progressive taxation replicate the system for payment of WorkCover – ie that the club predict its gaming turnover and pay gaming tax in advance based on this prediction. At the end of the year the an adjustment can be made in accordance with the actual income.

ClubsVIC representatives would be pleased to discuss any of the matters raised above, and in particular the *Minimum Entitlement for Pre-Commitment* proposal.

