

Extension of Term for Victorian Gaming Machine Entitlements

The Victorian Government committed to a review of the Gaming Machine Entitlement Term (the "Review") in response to a request on 26 August 2013 by the Australian Hotels Association, Clubs Victoria, the Returned Services League of Australia Victorian Branch and the Community Clubs Association of Victoria for Government to consider extending the term of gaming machine entitlements.

Accordingly, the Victorian Department of Treasury and Finance ("DTF") this month issued "Review of the Gaming Machine Entitlements Term Issues Paper June 2014" (the "Issues Paper") providing some background and inviting submissions from interested parties by 30 June 2014.

Background

The Issues Paper notes:

"On 16 August 2012, a new venue operator model for gaming machines commenced. Under the new industry arrangements, venue operators may operate gaming machines if they hold gaming machine entitlements. A gaming machine entitlement authorises a venue operator to operate one gaming machine in an approved premises for the term of the entitlement.

In 2010, the former Government created 27,500 gaming machine entitlements and allocated the entitlements to venue operators through the pre auction club offer (PACO) and the auction process.

In total, 27,300 entitlements were to be allocated to club and hotel venue operators for a value of \$980 million.

Each entitlement has a 10 year term from 16 August 2012 to 15 August 2022.

Under the new industry arrangements, venue operators are directly responsible for the conduct of gaming in their venues. This includes responsibility for acquiring and operating their own gaming machines and equipment, paying regulatory costs, the monitoring services fee, supervision charge and gaming machine taxes.

Whilst venue operators incur additional operational costs under the new industry licensing arrangements (e.g. they are required to pay fees for gaming machine monitoring), they retain an increased share of gaming machine revenue compared to the previous arrangements".

Industry Concerns

According to the Issues Paper, the industry submitted that uncertainty had been created and has resulted in significant commercial challenges to venue operators because:-

- “1. the necessary capital expenditure that is required to continue operating profitably will reduce by 2016, which the industry predicts will detrimentally affect gaming machine revenues;*
- 2. some venue operators are struggling to obtain bank finance, placing existing leveraged businesses at risk and reducing new investment in the industry; and*
- 3. venue operators have developed long term business models based on continuity beyond 2022, which in the absence of an extension to entitlement term will lead to hotel and club businesses becoming unsustainable after that date.”*

The Issues Papers invites submissions to evidence and substantiate the concerns listed above.

It also identifies criteria by which the case for extending the term of entitlement will be assessed together with the Governments objectives for a potential extension of the term of entitlement.

It is also noted that in New South Wales, Queensland, South Australia and the Northern Territory, gaming machine entitlements were issued in perpetuity.

The Issues Paper also seeks input on valuing an entitlement extension period, the options for extending the term of entitlement and the key attributes for allocation processes “offering 2 models to prompt discussion”

Consultation Process

The Review is being jointly managed by the DTF and the Department of Justice (“DOJ”). It is envisaged that the consultation process will involve “Regular Gaming Venue Operator Round Table meetings with the relevant peak bodies. Peak bodies will be able to consult with individual venues at their discretion”.

QUESTIONS

The following are questions articulated by DTF and DOJ as being of particular interest to them:

Nature and extent of the issue

Question 1

Further evidence is sought to substantiate industry claims regarding the impact of the 10 year entitlement term, in particular evidence to show:

- that the difficulty in obtaining finance is directly related to the current entitlement term and extending the term would improve the confidence of lenders; and
- how the 10 year entitlement term has affected gaming machine operations, including information such as capital costs, capital refresh and operating costs.

Question 2

It will be helpful to better understand venue operator's likely strategy for seeking bank finance at the high level, in particular:

- what are the different classes of assets that venue operators use to obtain bank finance?
- What are the respective proportions for each asset class in obtaining the venue operators' total lending requirements, including gaming machine entitlement?
- How reliant are venue operators on gaming machine entitlements with respect to overall lending requirements?

Question 3

In section 2.3, [of the Issues Paper] the nature of the problem claimed by the industry was identified. Are there any other problems (e.g. market failures), that arise from the current term of entitlements? If so, please explain and provide supporting evidence.

Question 4

Given the problem as articulated by the industry, are there any other options that would address this problem apart from extending the term of entitlements?

Valuing an entitlement term extension**Question 5**

What kind of capital, operating and other business costs are faced by venue operators and what proportion of play loss do they generally constitute?

Question 6

What are the costs of capital consideration faced by venues seeking access to finance? What is the appropriate discount rate which should be applied in this instance, including an appropriate risk premium?

Question 7

Is the valuation method reasonable in reflecting venues' cost structures? Are there any other variables that the Review should consider?

Options to extending the entitlement term**Question 8**

What proportion of entitlement holders might want to extend the term of their existing entitlement? What segments of the market will the desire to extend the term of entitlements come from (e.g. metro vs. regional; clubs vs. hotels sector, etc)?

Question 9

Within the regulatory constraints on the ownership of entitlements, should existing entitlement holders and potential new approved entrants be able to apply for an extension to an entitlement that is not theirs?

Question 10

Within the regulatory constraints on the ownership of entitlements, what proportion of entitlement holders would seek to increase or decrease the number of entitlements they hold as part of an entitlement extension process? For example, would venue operators seek to compete for entitlements that are currently not theirs? What segments of the market will the desire to apply for an extension to an entitlement that currently is not theirs come from (e.g. metro vs. regional; clubs vs. hotels sector, etc)?

Question 11

Would a uniform length of extension for entitlement term or available length be more appropriate noting that industry would be required to pay a fair market price for any entitlement extension?

Question 12

If a uniform length of extension is preferred, would a shorter or a longer entitlement term extension be more appropriate noting that industry would be required to pay a fair market price for any entitlement extension? Please provide reasons for your preferences.

Question 13

If venue operators have a choice of extension length, what lengths should be available, noting that industry would be required to pay a fair market price for any entitlement extension. Please provide no more than four length options.

Question 14

What is the preferred payment method for a possible entitlement extension; an upfront payment or instalment payments across the life of the extension?

Question 15

Would an administrative process for the extension of entitlement be appropriate? Are there any other advantages or disadvantages to his model?

Question 16

What are the key issues and variables for consideration in determining the price to be paid under an administrative process?

Question 17

Should the price formula enable different prices to be set for different classes of entitlements?

Question 18

Would a competitive process for an extension to entitlements be appropriate? What would the advantage or disadvantages be?

Question 19

Should a competitive process enable venue operators to bid for different entitlements, how much competition is expected for an extension to the term of entitlements? Where would this competition come from? It would be helpful to provide information to these questions at the level of analysis available (e.g. hotel vs. clubs sector, regional Victorian vs. Metropolitan Melbourne, particular capped areas and Local Government Areas, etc).

Question 20

Within the current regulatory constraints, would venue operators like to increase or decrease the number of entitlements they hold as part of a potential extension process?

Question 21

Do venue operators have a high degree of certainty around the value of a potential extension to the term of their entitlements?

Question 22

In comparing the two different models, which model would be more appropriate for a potential extension to the term of entitlements? Please provide reasons for your preferences.

Question 23

Are there other allocation models that should be examined as part of the Review?

Question 24

Are there other criteria that should be considered as part of the assessment and why?

Proposed Timetable

Key Deliverables	Date
1. Project Scope Statement finalised	June 2014
2. Issues Paper	June 2014
3. Public Submissions on Paper	30 June 2014
4. Interim Report: <ul style="list-style-type: none"> • Assess the role for government in extending the term of entitlements; provides a fair market valuation for potential entitlement extension, and evaluates potential options; • Further consultation with the peak bodies 	July 2014
5. Stakeholders submission on interim report	August 2014
6. Final Report submitted to the Government	August – September 2014
7. If required, design, development and implement the selected allocation process to inform entitlement selections from September 2014	From September 2014

It is understood that most clubs have received a copy of the Issues Paper from the DTF and will be either considering their own submissions or providing input into submissions from the peak bodies.

The Issues Paper can be downloaded from www.dtf.vic.gov.au

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