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Dear Angus

**RE: CATEGORISATION OF VENUE COSTS UNDER THE GAZETTE NOTICE AND REASONABLE TIMEFRAMES ASSOCIATED WITH LABOUR TASKS**

Thank you for the opportunity to respond to the Department of Internal Affairs' (the Department's) draft guideline consultation paper on its approach to the assessment of venue costs.

As suggested by the Department, New Zealand Community Trust (NZCT) has provided our Venue Operators with the consultation document and canvassed their response. The Department has been sent copies. Two key findings are:

- Over 80% of Venue Operators considered the maximum times allocated for Cancelling credits, Supervision and Shift Changes were unreasonable
- In terms of the likelihood of this proposal causing them to withdraw from gaming, 24% said they were either likely or very likely to have their gaming machines removed

In our submission there are three observations that form the body of our response:

1. The Standardised cost model, 'one size fits all' approach leads to a failure to recognise significant variations in costs between venues;
2. Non recognition of legitimate actual, reasonable and necessary costs;
3. Wider effects and implications of the draft guidelines;

**1. INTRODUCTION**

- 1.1 NZCT supports and agrees that the development of a set of robust guidelines would improve policy development and decision making by Trusts in support of the rationale of the current legislation.
- 1.2 However it is considered that the draft guidelines in their current state as proposed are excessively restrictive, too conservative and unbalanced.
- 1.3 It is crucial that we work together constructively to develop a balanced solution that reflects the commercial reality of the environment in which we operate but is also legislatively compliant, sensitive in nature and acceptable to all parties involved.

- 1.4 If adopted in its current state, we consider as detailed in our submission that the proposed draft guidelines will have a potentially debilitating effect upon venue operators who provide their premise for the purpose of fund raising for communities.
- 1.5 More importantly it could potentially reduce the amount of money societies can donate to charitable organisations, including sporting organisations, educational institutions, health institutions, the arts and other charitable purposes.
- 1.6 Additionally we observe the Department states on page 2 of the paper that *"It is important to note that these reasonable timeframes represent the **maximum** [emphasis added] amount the Department will consider is reasonable to attribute to any particular cost."* Therefore we are cognisant that decisions made as a result of this consultation process are likely to end up as more than a 'guideline', they become a set maximum prescription.

## 2. STANDARDISED COST APPROACH

- 2.1 While the intention of the Act is clear, it is considered that none of the objects of the Act are advanced by making a 'one size fits all' draft guideline for the controlling of venue payments. Particularly when the activities detailed are varied between venues as identified within the various studies undertaken. The discriminatory consequences that will result from the enforcement of these guidelines are considered at odds with current legislation.
- 2.2 While the simplicity of a cap on the maximum level of venue payment is acknowledged; we cannot reconcile this with a requirement for payments to be 'actual, reasonable and necessary'. If payments are required to be 'actual, reasonable and necessary' then it is considered any amount justified would be legally payable.
- 2.3 The major weakness of a standardised cost model through the adoption of a "one size fits all" approach is that it fails to recognise the significant variations in costs between different venues.
- 2.4 In 2003, NZCT engaged PricewaterhouseCoopers (PWC) to look into the issues of 'actual, reasonable and necessary'. The differences in operating costs identified include:
  - the seniority of the person performing the tasks;
  - hourly rates;
  - procedures followed;
  - level of turnover;
  - number of machines
  - existence of change machines; and
  - location of venue (affecting rental costs)

- 2.5 An indication of the extent to which costs vary across the different venues can be obtained from the PWC report, if required. Even within the one city (Wellington) examined by PWC, venue costs varied by over 70% and ranged between \$197 per machine per week and \$366 per machine per week.
- 2.6 The standard cost approach that is proposed has arbitrary and unreasonable effects. Each venue needs to be considered on a case-by-case basis.
- 2.7 The variation in venue costs between different cities and between cities and rural areas is likely to be even larger.

### **3. NON RECOGNITION OF LEGITIMATE ACTUAL, REASONABLE AND NECESSARY COSTS**

#### **3.1 Common Areas**

- 3.1.1 It is considered that the draft guidelines have not taken into account the calculation of common areas for gaming machines. The report only caters for the actual gaming machine floor space and makes no allowance for common areas.
- 3.1.2 It is considered that some allowance for common areas should be made in the floor rental payment calculation. It is not 'should we include it?' but rather 'how much should we include?' Clearly other areas of the operators premise are used / provided for gaming machine patrons.
- 3.1.3 The following should be given further consideration:
- There is no additional cost to the venue operator in relation to the premises cost for gaming machines. The operator 'chooses' to use some of the existing premises (and sunk lease cost) to provide gaming machines. They could easily choose to use it to conduct other business activities;
  - If a society was to establish gaming machine activities in a standalone manner, they would need to lease premises that included car parks, toilets, counter and administrative space to undertake gaming machine activities;
  - We consider it is important to view the business of raising funds for the community from a 'whole of business' perspective and not just the narrow interpretation, which is the floor space occupied by machines.
- 3.1.4 Experts independent to the operator should be used to determine the total floor space used by gaming machines. This would comprise:
- the actual floor space utilised by the gaming room;
  - plus an allocation for common areas that are used for gaming machine activities (toilets, bar, car park, walkways etc).
- 3.1.5 Overall the methodology adopted by the draft guidelines is not consistent with the principle of recovering actual, reasonable and necessary

expenditure. An appropriate allowance for joint and fixed costs should be considered in any gaming venue costing model.

- 3.1.6 Additionally, building regulations specify that certain requirements must be met, such as maximum distances from the gaming machines to exits and whether additional toilets are required to cater for the gaming machine patrons.
- 3.1.7 It is considered arbitrary to on one hand to pass regulations requiring venues to incur certain costs associated with gaming and on the other hand to pass guidelines not allowing the venue to be reimbursed for these costs.

## 3.2 Labour Cost

- 3.2.1 It is considered that there is a fundamental difference between the draft guidelines and the commercial realities that govern the successful operation of gaming machines on hotel premises.
- 3.2.2 This is highlighted with the draft guidelines analysis in relation to the labour cost.
- 3.2.3 Independent studies have all indicated that in the majority of all high turnover venues, that there is a minimum of two staff members required at all times during opening hours, even during the slow parts of the day. One of these staff members would not be required if the venue did not provide gaming machines.
- 3.2.4 Staff frequently need to attend to those using the gaming machines, to refill hoppers, clear glasses, provide drinks, cancel credits and provide payments. This requires the staff to leave the bar unattended. With large amounts of cash held behind the bar, (often related to gaming machine floats), this activity poses a major inherent security risk.
- 3.2.5 Therefore in calculating the labour costs on a simple marginal cost basis in relation to gaming machine activities, it is not possible to break a particular job down into its constituent tasks and then only employ a person for the cumulative amount of time involved.
- 3.2.6 Although the specific staff member would not be spending the entire day attending to the gaming machines, it can be argued that without any gaming machines, a second staff member would not be required at all.
- 3.2.7 Additionally the regulatory environment requires that a trained person be on duty in the gambling venue at all times when Class 4 gambling is available. This reinforces the argument that each venue must employ at least one full time equivalent staff person for the hours the venue operates to meet legal obligations.
- 3.2.8 When calculating the labour costs on a considered basis, caution must be taken not to apply a 'stopwatch model' approach but to include 95 - 100% of one full staff member for the average daily opening hours as more balanced, fair and reasonable.

3.2.9 By not effectively addressing this underlying cost it results in an unbalanced reimbursement of 'actual, reasonable and necessary' costs.

### 3.3 Electricity

3.3.1 Basing the electricity cost on a direct portion of venue space is both arbitrary and unreasonable. The gaming area consumes a considerable amount of electricity. This is disproportionate to all other areas within a class 4 venue.

3.3.2 Konami, a gaming machine manufacturer, has distributed a framework detailing the accurate power consumption of a Konami Gaming Machine.

3.3.3 From the analysis it is noted that the cost of operating 18 gaming machines (not including the jackpot, EMS system, lighting, gaming till, CCTV etc) is higher than the draft guidelines provide for.

### 3.4 Data

3.4.1 The use of 2008 data to determine the numbers of cancelled credits etc for 2009 is considered flawed. 2009 data from PIDS enabled machines shows a much higher incidence of cancelled credits and subsequently a higher workload for venue staff.

### 3.5 Reimbursement of Capital Costs

3.5.1 The assertions about Limit C in the draft guidelines and the treatment of capital costs of venue enhancements are considered erroneous.

3.5.2 The venue is the presence of the society on the venue operator's premises. It is considered that all venue upgrades should be a society cost as societies require a certain standard in each room. This is especially prevalent in the minimisation of theft (CCTV) and harm (lighting).

3.5.3 In addition, as we are effectively leasing the space from the venue operator then in a normal commercial situation all leasehold improvements would be paid for by the lessee.

3.5.4 As previously advised by the Department, the fundamental rule should be that if the enhancement can be removed then the society should be entitled to pay. It should be a capitalised cost and therefore provided by the Society.

3.5.5 In this circumstance the society pays then likewise the venue cannot then claim a payment under Limit C for the same items.

### 3.6 Harm Minimisation

3.6.1 The proposed guidelines may also impact on the broader regulatory regime governing Class 4 gambling. Harm minimisation regulations require that staff are more highly trained in matters relating to problem gambling.

3.6.2 The imposition of caps without providing for the opportunity to reimburse 'actual, reasonable and necessary' expense needed to adequately supervise the use of the gaming lounge could lead to less motivation towards the domain of the Trusts Harm Minimisation Strategy, not help it.

#### **4. WIDER EFFECTS AND IMPLICATIONS OF THE DRAFT GUIDELINES**

- 4.1 The current payment regime of reimbursement is already complex and attempts to achieve multiple objectives. Given this, concerns about rising costs and potential abuse are likely to arise in any venue payment regime based on the premise of the existing model.
- 4.2 The immediate effects of the draft guidelines in the current state may not be large on some venues. However, higher earning venues will almost certainly be affected.
- 4.3 Many will be forced to reduce costs, to the extent that the draft guidelines will more than likely lead to reduced operating hours and lower service levels. The consequences may result in reduced fundraising for the community and a reduced motivation towards 'duty of care' to the patron.
- 4.4 This is further compounded by the fact that there has been no Consumer Price Index (CPI) adjustment to the current system in the previous five years.
- 4.5 As a result, there is likely to be reduced funds available for the community and reduced revenue for the Government as turnover on the gaming machines is lower than would otherwise be the case. Most importantly, it is estimated that the top 30% of earning venues contribute around 70% of the industry profit. It is these venues that are likely to be most adversely affected by the guidelines.
- 4.6 The guidelines adopt an unreasonable approach to the reimbursement of 'actual, reasonable and necessary' costs. As a result it is likely to lead to various distortions and anomalies. These include but are not limited to:
- If the ability of the trusts to pay venues sufficiently for operating the gaming machines is diminished; it is likely that venues will reduce staff numbers. This will have a detrimental impact on the ability of venues to supervise the use of gaming machines and will thus undermine the Trusts Harm Minimisation Strategy;
  - The creation of caps may have the effect of increasing venue payment costs as lower earning operator's recover up to the allowable cap;
  - The draft guidelines may lead to changes in business structures as people seek to obviate the restrictions imposed by the regime. For example, it may lead to venues and especially high volume venues migrating to clubs and becoming end user trusts for which there are different rules.
- 4.7 Many of the changes are likely to lead to reduced efficiency within the industry as a whole.

4.8 Furthermore the guidelines are likely to lead to increased compliance costs. These costs are likely to include:

- The costs incurred by the venues in maintaining records (especially labour) for audit/inspection purposes;
- The costs incurred by the societies in complying with the guidelines. Due to the complexity of the system consideration would have to be given by trusts of a certain size to the employment of a dedicated Venue Payments Manager.
- The increased costs incurred by the Department in providing data, monitoring and enforcing the guidelines

4.9 It is considered that unreasonable capping of inputs will create an environment contrary to the intentions of the Act. It is entirely appropriate that a test of reasonableness be applied to the guidelines. It is submitted the draft guidelines proposal should be reviewed because:

- It has arbitrary consequences for the industry;
- It has unreasonably high compliance costs which may increase significantly as a result of the guidelines;
- It will be erroneously complex and arbitrary to implement;
- The effects of the draft guidelines as proposed will be to reduce the fund raising abilities of the Trust on behalf of the community;
- The draft guidelines are based on methodology that has fundamental limitations and is considered inappropriate for reimbursing 'actual, reasonable and necessary' costs.

## 5. CONCLUSION

5.1 It is submitted that there are better alternatives available that are being contemplated at this time, such as a commission based model.

5.2 This is the most viable payment model being a consistent, fair and cost effective system based on the turnover of the gaming machines, facilitated by EMS.

5.3 In the calculation of turnover, EMS is a proven, transparent and accountable base on which to model a solution for all stakeholders.

5.4 We accept that Section 115 of the Gambling Act prohibits the payment of commission for conducting Class 4 gambling. However we note that the same rule does not apply to any other form of gambling regulated under the Act. Therefore it appears that the Government is not entirely opposed to the concept of payment by commission.

- 5.5 The proposed draft guidelines are complex and considered unlikely to be effective in improving overall efficiency, improved transparency and accountability. Rather it may lead to reduction in services.
- 5.6 The implementation of a stopwatch 'one size fits all model' while there is willingness towards a simple commission based system is an inefficient use of time and resource by Societies, Venue Operators and the Department.
- 5.7 We look forward to working further with the Department to establish an appropriate solution that is aligned with both the spirit and the intent of the Act.

Yours sincerely



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