



VICTORIAN CASINO & GAMING AUTHORITY

DECISION AND REASONS FOR DECISION

In the matter of section 136A of the
Gaming Machine Control Act 1991

and

In the matter of an Inquiry to determine
whether a declaration should be made in
relation to the Manningham Club
Limited

DECISION

Authority: Mr B. Forrest, Chairman
Ms U. Gold, Deputy Chairperson
Dr D. Hore, Member

Date: 29 June 2004

Decision: The Authority decides:

- (1) not to make a declaration under section 136A(1) *Gaming Machine Control Act 1991*; and
- (2) to recommend that for the reasons stated in paragraphs 36 and 37 of the Reasons for Decision the application of section 136A(1) be reviewed at the expiration of 12 months from the date of this decision.

Sgd. B. Forrest
Chairman

REASONS FOR DECISION

29 June 2004

**Mr B. Forrest, Chairman
Ms U. Gold, Deputy Chairperson
Dr D. Hore, Member**

- 1 This Inquiry by the Victorian Casino and Gaming Authority (“the Authority”) is held pursuant to section 111 of the *Gaming Machine Control Act 1991* (“the Act”). The purpose of the Inquiry is to decide whether the discretion pursuant to section 136A of the Act has been enlivened and if so whether the Authority should exercise the discretion to declare that the amounts payable from gaming revenue to the venue operator, the Manningham Club Limited (“the Club”), are to be paid as if the licence held by the Club was a general licence under section 8 of the *Liquor Control Reform Act 1998* (“the Liquor Act”).
- 2 A preferential rate of return from gaming machine revenue is enjoyed by club venues. In respect of these venues, the venue operator receives from the gaming operator thirty-three and a third percent of the daily net cash balance of revenue from gaming machines: section 136(3)(a)(i) of the Act.
- 3 The rationale for the public policy whereby a preferential rate of return applies to club venues is that clubs provide benefits to their members and the community generally and for that reason, it is deemed worthy that the community, in effect, subsidise the lower rate of tax on the proceeds of gaming at club venues. Private operators who conduct gaming at hotel venues do so for private profit and operators of these venues receive a lower rate of return as a consequence of the eight and a third percent of the daily net cash balance being paid into the consolidated fund.

4 The effect of a declaration being made under section 136A of the Act is that the gaming operator would be required to pay the club venue operator twenty-five percent of the total daily net cash balance, and to pay eight and a third percent to the consolidated fund, the same as the rate of return applying to hotel venues, being premises at which a general liquor licence is in force.

5 Section 136A of the Act provides:-

“136A. Declaration of different rate of return

- (1) If a licence referred to in section 12A(1)(b) is in force in respect of an approved venue and—
 - (a) the freehold of the approved venue is not vested in the venue operator; or
 - (b) in the opinion of the Authority, the terms of the lease of the approved venue or any other agreement provide, whether directly or indirectly, for payment of rent or charges calculated by reference to revenue derived from gaming machines; or
 - (c) in the opinion of the Authority, the terms of an agreement provide, whether directly or indirectly, for payment of revenue derived from gaming machines to a person other than the holder of the licence referred to in section 12A(1)(b)—

the Authority may declare that the amounts payable by the gaming operator under section 136 are to be paid as if the licence were a licence referred to in section 12A(1)(a).”

6. In *Kilsyth and Mountain District Basketball Association* (Decision 2 April 2003) the Authority said in relation to the construction of 136A:-

“7. In the ordinary meaning of “or”, paragraphs (a), (b) and (c) are read disjunctively. Although a situation where (b) may apply independently of (a) would arise if a club is the owner of the freehold of a venue and is also a party to a lease as the lessor, we are of the opinion that is not a situation which section 136A is intended to address. In our opinion reading paragraphs (a) and (b) conjunctively is in harmony with a construction that would

promote the purpose of the section. Furthermore, the use of the words “the lease....” in paragraph (b) suggests that (b) is to be read with (a) and not as an alternative”.

7. Mr Wheelahan, counsel for the Club, submitted this approach was correct and should be followed. Mr Sievers, counsel assisting the Authority, submitted that the history of the provision, which he traced in submissions, suggest that the word “or” in section 136A(1)(a) should be given its literal interpretation and read disjunctively. There is some force in that submission. However, we propose to follow the reasoning in the Kilsyth case which we think is correct. For completeness and to avoid any misunderstanding we would add that paragraph (c) of section 136A(1) is to be read literally as an alternative ground to paragraph (b).
8. If we are wrong in our construction of the provision then at an appropriate time it will be for the Supreme Court to give judicial guidance. However, for the purposes of the present case, it is immaterial whether the construction we have adopted or the contrary view is correct, because of the findings we make. For the reasons that follow both paragraphs (a) and (b) of section 136A(1) apply so as to raise the question of the exercise of the discretion.
9. In addition to the documentary material before the Authority (2 volumes) oral evidence was given by Seng Chan, senior analyst, Office of Gambling Regulation, Andrew Spinks, company director, Robert Butterworth, qualified valuer and Leslie Butterworth, president of the Club.
10. The background facts and circumstances are set out in the following paragraphs 11 to 19 inclusive.
11. The Club was formed in 1995 as a company limited by guarantee having initial support from predominantly local sporting bodies. It opened in

1996 initially with a bistro and bar area occupying part of the premises at 1 Thompsons Road Bulleen, once known as the Sentimental Bloke hotel/motel. The Club is the holder of a full club licence under section 10 of the Liquor Act. Another part of the premises is a hotel for which a general licence is held. A venue operator's licence under the Act to operate 100 gaming machines was granted to the Club in February 1996.

12. The Club premises were leased from Rivcorp Pty Ltd, the freehold owner of the property. The hotel section of the property was leased to Deltane Pty Ltd, a company associated with Rivcorp. The Club lease from Rivcorp commenced on 29 June 1996 for an initial period of 5 years with the option of two further terms each of 5 years. The lease provided for a rent of \$450,000 per annum for the first year. The initial rent of \$450,000 per annum was, in the opinion of valuer Robert Butterworth, the then current market rental for the club component of the property. The lease provided for annual reviews to determine market rent and in the absence of agreement to be determined by a valuer (cl.11) who must determine a market rent of not less than \$100 less than the current rent before the review (cl.11.1.5) and for the third to fifth years respectively of not less than 4% per annum or greater than 7% per annum (Schedule Item 6). The lease was varied on 1 December 1997 to provide that the rental during each 12 months of any further term is to be determined by reference to clause 11 of the lease (by agreement or in the absence of agreement the current market rent as determined by a valuer) and shall be the higher of a) the rent so determined which shall not be greater than the rent payable during the previous 12 months preceding the review increased by 7% or b) the rental for the previous 12 months period plus 4%.
13. The lease was renewed for a further five year term commencing 29 March 2002 at a rent of \$735,000 per annum being the current market

rent as assessed, again by valuer Robert Butterworth. In evidence Mr Butterworth described the steps he took in making his valuation. These included an inspection of the facility and an examination of the trading results over the past 5 years. In assessing rental he used a percentage of turnover and/or profitability. Mr Butterworth noted gaming turnover increased substantially between the five years analysed and a substantial increase in bar and food turnover in the 2002 financial year period following the renovation of the bistro. Adjusted net operating profit for the 2001 year for rental valuation purposes was 13% food and liquor and 55% gaming. The valuation of \$735,00 as the market rental at 29 March 2002 comprised as a percentage of turnover 8% bar and food and 20% gaming commissions.

14. During the first term of the lease the premises were substantially redeveloped and modernised. In 1996-1997 Rivcorp completed the gaming lounge and main bar area. In 1999-2000 a gymnasium, a function centre (part of the hotel licenced area) and a main entry for the Club and the hotel function centre were constructed. One reception area services both the Club and the hotel function centre. Common car parking areas, entrance driveways and lighting works were also completed.
15. In 2001 the Club undertook a refurbishment and fit out of the bistro and kitchen areas as tenant's improvements costing \$900,000. Rivcorp completed structural work including the balcony for the bistro, costing \$100,000.
16. The Club entered into a management agreement with Victorian Hospitality Management Services Pty Ltd ("VHMS") in June 1995 to manage the operation of the Club. VHMS is owned by Andrew Spinks who is also a director and shareholder of the freehold owner, Rivcorp. The management agreement was for a term of 5 years with two options

each of 5 years at an initial fee of \$262,500 per annum and commenced simultaneously with the lease of the Club premises. The management agreement provided for yearly reviews of the management fee to be determined by a chartered accountant in the absence of agreement. In the event that the net profit varied from the annual budget by more than 10% up or down either party may request a review.

17. The evidence revealed that the management fees in some early years were not paid according to the agreement but on the financial ability of the Club to pay. In some years, shortfalls in fees were converted to loans, since repaid, and at some other times services were reduced to align with reduced fees. The management agreement was renewed in March 2001 at a fee of \$300,000 for the first year of the renewed term.
18. On 11 July 2003 VHMS sold the management rights to BLM Club Management No. 1 Pty Ltd. In addition to being subject to regulatory approval, the sale of the management rights was also subject to the sale of the freehold property by Rivcorp and of the hotelkeeper's business conducted on the property by Deltane Pty Ltd to Manningham Property Pty Ltd a company which, similar to BLM Club Management, is owned by the Mathieson group. The transfer of the management rights and the freehold property were completed on 12 January 2004.
19. The Club premises offer a bistro, bars (2), gaming lounge, meeting room, also a gymnasium which is leased to a private operator. The Club President, Leslie Butterworth said the Club has approximately 6,000 members in three categories of membership Full (\$27), Senior (\$17) and Social (\$2) annual subscriptions. A promotional brochure lists the benefits of membership, a courtesy bus within 5km of the Club, discounted beverages in gaming and bistro bars, transaction bonus points, complimentary birthday meal, sub clubs – food and wine, tennis, golf, angling, right to sign in guests, special offers, club newsletter, 10%

off gymnasium membership and discounts at hotel bottleshop and motel. Other advertised benefits were a weekly seniors' day, live entertainment, club nights for single members and guests and occasional excursions. Under the Club umbrella there is an angling club (18 members), food and wine club (80), golf club (33) and a tennis club (51). The Club has a boat for use by the anglers while nearby municipal facilities are hired for the tennis and golf players.

20. Mr Wheelahan submitted that paragraphs (b) and (c) of section 136A(1) do not apply to the lease and management arrangements. In relation to paragraph (b) the submissions in summary were that the lease does not provide for rent to be calculated by reference to gaming revenue either directly or indirectly; that a market assessment of rent does not involve a calculation of rent by reference to gaming revenue but is an exercise in intuition; that having regard to the statutory sanction of market rent review in the retail tenancy legislation it is inconceivable that the legislature intended by the existence of a market rent review provision in the lease that the Club would be subject to the discretion in section 136A; that a lease in which rental is fixed for one year and subject to an increase, minimum 4% - maximum 7% in following years (see clauses 11 and 16 and Schedule Items 6 and 16) is not a rental "calculated", that is, ascertained by mathematical means within the meaning of the word "calculated" in paragraph (b). Mr Sievers on the other hand submitted that there is an indirect connection between gaming revenue and rent on the basis of the valuation reports and evidence of Mr Butterworth.
21. We turn to consider these submissions. Paragraph (b) in its terms has a broad scope in that the Authority is required to form an opinion as to whether the terms of the lease or any other agreement provide whether directly or indirectly for payment of rent or charges calculated by reference to revenue derived from gaming machines. We are satisfied

that the terms of the lease do not directly do so. The question then arises as to whether there is an indirect connection.

22. When the initial determination of \$450,000 rent per annum was made as the commencing rent, the valuer took a number of factors into account. He had estimates of projected gaming revenue which were forecast to account for more than 50% of the Club revenue, subsequently confirmed by actual figures. Absent the gaming revenue stream and using the valuation methodology employed would undoubtedly to our minds have produced a substantially lesser figure for rent than the amount as determined by the valuer which became a term of the lease.
23. Projected and/or actual gaming revenue played a pivotal role in the rental assessments both when the lease commenced and when it was renewed for a further term. The fact that other streams of revenue were also taken into account does not in our view negate the language and intent of paragraph (b). The provision requires a direct or indirect connection; it does not require a calculation of rent that is related to gaming machine revenue to the exclusion of all else. Furthermore, rent “calculated” is not in our view necessarily confined to mean a figure that is ascertained by mathematical methods, as was submitted by Mr Wheelahan. Another meaning is “to make a computation: form an estimate”. Further, the meanings given of the noun “calculation” include “2. Result or product of calculating 3. An estimate based on the various facts in a case; a forecast”: see *The Macquarie Dictionary* 3rd Edn. Mr Butterworth, in making the rent assessments exercised his professional skill, experience and judgement and in doing so “calculated” rental within the ordinary meaning of the word as it should be understood in the context and subject matter of paragraph (b).
24. A perusal of the annual reports and the evidence of the president of the Club gave further emphasis to the significance of gaming revenue and

the reality of the relationship between gaming revenue and rent. This is a club with 100 gaming machines producing the bulk of its revenue, not one with an insignificant adjunct to the dining experience. When the lease was renewed in 2002 the Club was reasonably comfortable with its capacity to pay the substantially increased rent. However, since the renewal, the downturn in gaming revenue following the introduction of smoking bans caused discomfort to the bottom line. The President said that despite predictions by Tattersall's and the management company that the downturn would be temporary, gaming revenue has not recovered to pre-smoking ban levels. This, notwithstanding increased food and bar sales since refurbishment of those areas. So much so that the reduction in gaming revenue underpinned the applicant's submission of the potential consequences in the event of the discretion being exercised. More about that later.

25. Reference was also made in submissions to the *Retail Tenancies Act* 2003. We do not read the provisions of that legislative scheme as detracting from the force of section 136A of the Act.
26. In our opinion the lease incorporates in its terms a rental of an amount which is indirectly related to gaming revenue.
27. In relation to the management agreement we are prepared to accept that having regard to the evidence in the witness statement of Mr Spinks and supplemented by his oral evidence regarding the calculation of the management fee, the terms of the management agreement, specifically clauses 8C and 8A, are not captured by paragraphs (b) or (c) of section 136A(1).
28. Having established, for reasons stated above, that there are grounds for the exercise of the discretion, by virtue of paragraphs (a) and (b) of section 136A(1), the question remains whether the Authority should

exercise the discretion by making a declaration that the Club be treated as if it were the holder of a hotel venue operator's licence.

29. It was submitted on behalf of the Club that a declaration should not be made, as the lease in providing for rent reviews accords with standard commercial arrangements sanctioned by statute. There is a short answer to this submission. If the lease, as we have found, is captured by paragraph (b) of section 136A(1) it is immaterial that the commercial arrangements are unexceptional.
30. Next, it was submitted that it is a fallacy to suggest there is an obligation on clubs for the purposes of section 136A(1) to benefit the community generally beyond that sector of the community comprising the members of the club. As a statement of principle that argument is a valid one for a club without a gaming venue but not for a club with a gaming venue, having regard to the purpose and intent of the concessional rate of gaming taxation for clubs. If the philosophy and aspirations of the Club are founded on the basis that it exists only for the benefit of its members then we would have difficulty in accepting that as a factor against making a declaration. That clubs have an obligation to the members goes without saying but the rationale behind the concessional rate of taxation is that clubs also benefit the community generally. The discretion in section 136A(1) is founded on a legislative intent that clubs should benefit from a concessional tax rate so that those benefits would flow on to the community as distinct from private operators who conduct gaming at hotel venues: see second reading speech of the then Minister for Gaming, Mr Storey. In fairness to the Club, the president's evidence did not suggest that the Club failed to recognise its wider responsibility in that there was evidence of assistance given by the Club to the general community although in the overall scheme of things it was, at best, modest.

31. The Club offers a range of social, recreational and entertainment opportunities for members and visitors and although it is a members' club, entry for visitors is a simple exercise. The Club premises and the hotel licensed area are housed under the one roof with some shared amenities. In a hotel with a gaming venue it is not unusual to find generally similar social and recreational opportunities to those offered by the Club, for instance, dining areas, discounted meals and drinks for common interest groups, social and sporting sub-clubs, meeting rooms and the camaraderie of other patrons. In other words, the point that the Club provides a community benefit through its facilities may be made equally by many hotel venues.

32. Overall there does not seem to be a great deal as would distinguish the Club and its activities from those offered by many hotels. Also, in this case the Club is managed in the same interests as the adjoining hotel licensed premises and freehold owner. While it is not unusual for club gaming venues to be on land where the freehold is not vested in the venue operator, we see paragraph (a) as identifying the possibility that where the premises are owned by outside interests, the preferential tax rate on gaming revenue, intended for clubs because of their community contribution will actually benefit the freehold owner. We are fortified in this view by the increasing trend of clubs with gaming licenses being seen as attractive investment vehicles for private investors.

33. Further it was submitted on behalf of the Club that the financial consequences of a declaration would likely be the voluntary winding up of the Club. In evidence Mr Brent Murphy, auditor, produced a comparative table showing that on the 30 June 2003 results, a modest operating profit of \$22,515 would instead have been a substantial loss if the preferential rate of tax was forfeited. In 2001 and 2002 the Club

made significant profits and undertook a \$900,000 refurbishment of the bistro.

34. In the event of a winding up, the Club would have nothing to show for the voluntary work of the officers and members in establishing the Club. The only beneficiary of a declaration being made would be the freehold owner in that the Club's improvements would endure not for the benefit of the members and the community, but for the benefit of the landlord. A demonstration of the Club position vis-à-vis the landlord was given by the president, Mr Butterworth, in evidence:

“We are currently trying to negotiate a better deal with our landlord. I don't know that we are going to be successful there. I am sure we (are) not; if this case doesn't get up, he has told us where we stand, is to put an administrator in and get out. He will find another club, he will take all our – all our assets will go.

Chairman: That is the response you got from your landlord, is it?

Mr Butterworth: Yes, we had a meeting on Friday.” (Tr. pp.113 - 114)

35. Where a declaration is made the impact of the loss of the concessional tax rate falls primarily on the club. That is intrinsic to the operation of the section, and a club under contractual arrangements with a landlord and/or manager is likely to be further financially disadvantaged, especially if the landlord is unmoved by the prospect. The types of arrangements to which section 136A is directed will in the operation of the section invariably result in a financial burden of varying severity to a club in the event of a declaration being made. Where, as here, the arrangements were, as we were informed, entered into at arm's length and with the Club having the benefit of legal and financial advice then in the normal course the Authority would give limited weight to financial hardship on this ground.

36. There is however another factor. Subsequent to the renewal of the lease in 2002 and following the introduction of smoking restrictions on 1 September 2002 there was a significant downturn in gaming revenue. For the year to 30 June 2003 the Club reported a 12% fall in gaming revenue (p.309 Book of Materials). Mr Butterworth said that on current figures it is nearer to 20% lower than pre-smoking restriction levels. This was an unforeseen circumstance which in a temporal sense is a relevant consideration. The timing of the downturn when combined with the effect that a declaration would have on the financial viability of the Club if it were to be made at this time is a sufficiently persuasive reason not to make a declaration.
37. In deciding not to make a declaration now we recommend that the question be reviewed in 12 months' time. Also, by then a reasonable period will have elapsed since the introduction of the community benefit statement under section 136AB of the Act which clubs are obliged to lodge for the first time in 2004. As part of the required community benefit contribution of eight and a third percent of gaming revenue, clubs have been permitted to claim salary and wage related costs which in reality are indistinguishable from similar costs in hotel venues. The further period will allow sufficient time to see what the Club has done in that time over and above the payment of salaries and wages.

I certify that the preceding 37 paragraphs are a true copy of the reasons for decision herein of: -

Mr B. Forrest, Chairman

Ms U. Gold, Deputy Chairperson

Dr D. Hore, Member

Signed: _____

Executive Assistant

Date of Hearing:

1 and 2 June 2004

Date of Decision: *29 June 2004*

Counsel for the Applicant: *Mr M. Wheelahan*

Instructed by: *Williams Winter, Solicitors*

Counsel Assisting the Authority: *Mr C. Sievers*

Instructed by: *Ms L. Corneliusen, Office of Gambling Regulation*