DRAFT

REVIEW OF BCLC's CASINO COMPENSATION MODEL

OBJECTIVE

BCLC would like to confirm that its current Casino compensation model is sufficient to provide Service Providers with the ability to service BC's gaming market both now and into the future. The scope of this review includes a financial review of its Service Providers current operations and a comparison of BCLC's compensation model to those operating in other jurisdictions.

BACKGROUND

BCLC's basic casino compensation model provides Service Providers with 25% of slot win, 40% of table games win and 3% FDC based on total gaming win. While these basic elements have remained consistent the following modifications have been introduced over the past several years:

- When BCLC introduced its vision for fewer but larger facilities with more amenities FDC was expanded to include a Service Provider's investment in these additional amenities (restaurants, live entertainment, meeting rooms, etc.).

- When electronic gaming was approved for Racetrack sites the casino compensation model was modified to provide the Racetrack Service Providers with 20% of slot win and 5% FDC. The total compensation package of 25% was made 3% lower than casinos to reflect 100% TITO machine operation (that required less labour) and not having to operate the more costly traditional table games. (When casino sites were later provided with TITO machines they were required to contribute 1.5% of gaming win to a joint marketing fund – this was not required by Racetracks.)

- Additional compensation was provided when craps and traditional poker were added to casino floors over the past several years. For poker a Service Provider receives 75% of the related win and for craps 75% of total win up to $270,000 and 40% over $270,000.

- Effective July 1, 2006 BCLC introduced an initiative to help Service Providers cope with increasing construction costs related to major new projects. Accelerated FDC (AFDC) provides for an additional amount equal to 2% of the total gaming win for projects approved by BCLC after July 1, 2006. This is a one time initiative that is limited to the initial redevelopment of a property.

Over the years there has been a reduction in the number of Service Providers within the Province and approximately 87.0% of BC's annual casino gaming revenues are currently generated by facilities operated by either Gateway Casinos or Great Canadian Casinos.

At the same time the number of BC Casino Service Providers with operations in other jurisdictions have increased, for example Gateway Casinos has gaming operations in Alberta, Great Canadian Casinos has gaming operations in Ontario, Nova Scotia and the United States and Paragon Gaming has gaming operations in Alberta and the United States. These factors make it more difficult to assess the performance of individual BC casino facilities and have introduced additional risks, i.e. BC gaming operations may be
s 21

BC's casino gaming revenues are expected to show continued growth over the next 3-5 years as new facilities are introduced and additional gaming equipment is added in order to meet current market demand. The majority of this growth will take place in the larger population areas including the Lower Mainland, southern Vancouver Island and to a lesser extent the Okanagan Valley.

Once gaming supply has caught up to demand the market will have matured and casino operators will have to survive on revenue growth related to demographic changes in order to cover increasing operating costs and protect their bottom lines.

PROFITABILITY OF BC SERVICE PROVIDER CASINO OPERATONS

It is difficult to assess casino gaming profitability based on information provided in Service Provider annual reports. This is due to revenues from all gaming and non gaming operations being included and limited information regarding the allocation of commons costs such as Head Office, financing, etc.

Great Canadian Gaming Corporation (Great Canadian)

The following summary was prepared from information provided in Great Canadian's December 31, 2006 annual report.

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Note: Total revenue and EBITDA include all sources, i.e. gaming, F&B, hotel, etc.

EBITDA as a % of Revenue from Great Canadian's BC and Ontario operations is fairly
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This suggests that BC's compensation model is towards the upper end of the jurisdictions (where Great Canadian operates) and provides them with a larger % contribution to their overall operation.

No breakdown of capital investment by jurisdiction was provided in Great Canadian's annual report so return on investment numbers by jurisdiction could not be calculated and compared.

Gateway Casinos (Income Trust and GCI)

Gateway operates 8 casinos in BC and 2 casinos in Alberta however their annual report does not provide revenue and EBITDA breakdowns between the jurisdictions. Based on the details included in their Income Trust Annual Report dated December 31, 2006 the following was calculated:

s 21

Note: Total revenue and EBITDA include all sources, i.e. gaming, F&B, hotel, etc.

Gateway's EBITDA as a % of Revenue is very similar to Great Canadian's operations in BC s 21 and Ontario s 21

As a further indicator of how beneficial BCLC's casino compensation model has been to its Service Providers the following recent transactions related to Gateway confirm their operations (mostly based in BC) are producing exceptional profits and returns for their owner's under BCLC's current compensation model:

Sale of Langley Casino from GCI to the Gateway Income Trust

s 21

Pending Sale of Gateway Casinos to New World Gaming (NWG)

s 21

Paragon Gaming (Edgewater Casino)

s 21

Smaller Independently Owned Casinos

In contrast to Great Canadian and Gateway BCLC has several smaller independent casino operators in locations such as Cranbrook and Quesnel that operate in market areas where gaming supply meets demand and populations have actually decreased in recent years.

Quesnel (Billy Barker Casino)

From their Financial Statements for the year ended August 31, 2006 the following was calculated:

s 21

Note: Total revenue and EBITDA relates to slots and table gaming and does not include amenity areas.

s 21

Cranbrook (Casino of the Rockies)

BCLC has not received an annual report for Cranbrook since the new ownership structure was put into place last year. While Cranbrook's 2006/07 gaming revenues were

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COMPARISON OF BCLC CASINO COMPENSATION TO OTHER JURISDICTIONS

As noted in the review of Great Canadian's operations it appears that compensation models produce very similar EBITDA as a % of Revenue in BC s 21 and Ontario s 21 however are considerably lower in Nova Scotia s 21 and the United States s 21

Possibly of most interest due to the similarity of their operating models would be a comparison between BC and Alberta. To do this the December 31, 2006 annual report of Game Host (a publicly traded Alberta Gaming Income Trust) was reviewed with the following results.

s 21

Note: Total revenue and EBITDA include all sources, i.e. gaming, F&B, hotel, etc.

Game Host has all of its operations in Alberta and they include; the Boomtown Casino in Ft. McMurray, the Great Northern Casino in Grand Prairie and is a s 21 partner in the Deerfoot Inn & Casino in Calgary. They also own a hotel and related strip mall in Grand Prairie.

The above numbers are interesting (and a little surprising) as Game Host produced a higher EBIDTA as a % of Revenues than both Gateway and Great Canadian in spite of
s 21

One explanation for this would be the better quality of casino facilities we have in BC and their higher related operating costs. Another explanation would be the Game Host operations are being run more efficiently and operating costs are more tightly controlled.

CONCLUSIONS

1. When compared to other jurisdictions BCLC's present compensation model appears to be one of the most favourable based on EBITDA as a % of Revenue.

2. BCLC's larger casino operators (Gateway, Great Canadian and Paragon) have facilities located in larger BC market areas where continued growth is expected over the next 3-5 years as gaming supply increases to meet existing demand.

3. BC's smaller independent casino operators are in locations where gaming supply already meets demand and populations are not increasing. As a result they will likely have difficulty remaining open over the next 5 years as gaming revenues will not increase at the same rate as their operating costs (labour, utilities, etc).

4. With the increasing number of Casino Service Providers having operations in other jurisdictions BCLC is becoming exposed to additional risk related to these companies s 21

5. Service Providers have been very quick to take advantage of opportunities to make one time profits based on BC's gaming market potential and the returns provided through BCLC's current compensation model. In the case of Gateway when BCLC's compensation model provided a significantly above average return
s 21

s 21

RECOMMENDATIONS

s 13(1)

ADVICE TO MINISTER
CONFIDENTIAL

ISSUES NOTE	
British Columbia Lottery Corporation **Date:** April 19, 2011 **Minister Responsible: Shirley Bond**	**Facility Development Commissions (FDC)- Van Sun Coverage**

SUGGESTED RESPONSE:

- **The Facility Development Commission (FDC) has been in place since BCLC was given the mandate to oversee and manage casinos in British Columbia in 1997.**

- **FDCs are a contractual obligation between BCLC and casinos, and commissions are earned over time based on the net win revenues generated by each casino.**

- **Through the facilities development commission program, service providers have earned over $400 million of service provider commissions - generating almost $6 billion in net income to government.**

- **This is a highly effective business model - in B.C. over 56% of revenue generated by casino gambling is returned to the province compared to about 35% in Quebec, Ontario and Nova Scotia.**

BACKGROUND:

On March 9, 2011, s 22 the Vancouver Sun contacted BCLC with questions about the Facilities Development Commission (FDC). They indicated they had been leaked several BCLC documents which included information about FDCs, specifically about commissions that were approved for Great Canadian Gaming's grand opening of the River Rock casino in 2004. *(Please see Q&A for detailed response from BCLC)*

In addition, on March 10, 2011, BCLC CEO Michael Graydon conducted an interview with the two Vancouver Sun reporters explaining the purpose and benefits of BCLC's commission model.

GENERAL BACKGROUND:

BCLC's compensation structure for private sector casino operators was introduced in 1997. It called for a total commission of 28 per cent of net win from slots and 43 percent net win from table games (net win = revenue after prizes paid/won by the player). The 28 per cent is divided into two parts – 25 per cent operating commission, 3 per cent Facility Development Commission (FDC) and 43 per cent is also divided into 40 percent operating commission and 3 percent FDC.

This compensation structure is captured in the Casino Operational Services Agreement (COSA), which are typically 10 or 20 year contracts. The COSA defines service operating and marketing responsibilities for the casino company and forms the basis for the 25 and 40 percent per cent operating commission. It also defines the requirements for earning the 3 percent FDC.

A key requirement for the casino company is the ability to obtain private sector financing for the casino facility and to design and construct the casino to high standards including amenities such as restaurants and lounge areas and approved by BCLC.

The other part of the compensation structure – 3 percent FDC – is designated for costs related to casino and ancillary amenities development based on BCLC guidelines, subject to BCLC review and approval. In other words, strings are attached to the 3 per cent FDC commission. The casino companies are required to hold the 3 per cent FDC commission, which is earned, based on net win, in a separate bank account and cannot access and recognize these funds on their books as revenue until they have incurred qualifying expenditures, which are the submitted to BCLC for review and approval.

FDC Report on BCLC.com:

In light of significant media attention in recent months around FDCs and about a dozen FOIPPA requests around the topic in the past year, BCLC has posted a detailed report on commissions paid to gambling service providers on BCLC.com that provides narrative around the origins and benefits of the B.C. model; explanation of how commissions are calculated; and criteria and guidelines for FDC and complete financials.

Link: www.bclc.com/cm/aboutbclc/corporatereports.htm

For more information, please contact:

Seumas Gordon
Manager, Issues Management & Media Relations
Corporate Affairs, BCLC
T 604 228 3027 C 604 209 0208

BCLC
Q&As with Vancouver Sun

Subject: FDCs for River Rock Casino

Date: April 19, 2011

On March 9, 2011, s 22 the Vancouver Sun contacted BCLC with questions about the Facilities Development Commission (FDC). They indicated they had been leaked several BCLC documents which included information about FDCs, specifically about commissions that were approved for Great Canadian Gaming's grand opening of the River Rock casino in 2004.

The following is BCLC's answers to the reporters' questions.

Q&A

1. Has the government or BCLC ever done audits of the requests casinos make for FDCs? That is, is there a paper trail or on-site inspections or proof of receipts that BCLC or the government sees? That is, if Great Canadian, for instance, puts in for $110,000 in FDC money to pay former Great Canadian president Adrian Thomas for consulting and training of gaming staff, does BCLC or the government then ask for proof that the training was done?

   On a rotational basis, BCLC conducts service provider head office reviews. This includes reviewing various service provider FDC submissions and using a sampling method to trace back items on the submissions to invoices.

   The FDC Program is one component of the total commission structure for BCLC service providers. Service providers are eligible to receive 3% of net win in commissions for qualifying expenses as identified in BCLC criteria. In this case, the Service Provider incurred the expenses and qualified to earn the equivalent to those expenses back through the FDC commission structure.

   River Rock casino was the first casino in B.C. to offer craps and poker – a major new product introduction involving time and effort to develop processes and controls. BCLC approved the consulting and training costs based on the nature of these games the fact that craps in particular requires extensive training and processes. This is a case where BCLC made a business decision to allow an expenditure to qualify where it was demonstrated that it would enhance the facility overall and the player experience.

2. As a crown corporation responsible for the regulation of gaming, does BCLC have any concern in apparent conflict-of-interests regarding the dispersal of FDCs, or, for that matter, the use to which FDCs go?

   BCLC determines the eligibility of expenses under its criteria but does not determine who does the work or approve the cost. Nor does BCLC set the cost for the work performed. Like any publicly traded company, River Rock has its own established procurement practices and is accountable to their Board of Directors and shareholders.

3. If Great Canadian opened River Rock in 2004-2005, and FDCs are awarded on the basis of earned net revenue, how then could BCLC remit FDC money to Great Canadian before the casino was actually making money?

   FDC has been in place since BCLC was given the authority to conduct and manage casino gaming in 1997. Great Canadian was eligible to earn FDC on expenditures incurred for former Richmond casino. Once River Rock opened, it began earning FDC on based on net win related to River Rock.

4. How much in FDCs and AFDCs have actually been paid out to Great Canadian since its construction? Was there an agreed-upon limit to the FDC amount before construction began?

   River Rock Casino opened in June 2004. As of March 31, 2010, Great Canadian has earned $50,517,135.48 in FDC and AFDC commissions for River Rock. Over that same timeframe River Rock has generated $1.1 billion in net win.

5. Is there an agreed-upon limit to FDCs a casino operator can receive, or can an operator receive them for the life of the casino?

   FDCs are part of the commission structure for service providers. The service provider is entitled to earn FDC throughout the lifetime of their operational service agreement as long as they remain the operator. In order to qualify to earn the 3% FDC, the service provider must incur expenditures that qualify for FDC and have these must be approved by BCLC.

6. Is FDC money held by BCLC in a separate account, and if so, how much is in the account now?

   No money is held by BCLC. BCLC's role is to review expenditure submissions based on criteria, deny or approve the request, and keep track of qualifying expenditures. As part of the commission structure, on a weekly basis, the service provider receives from the casino revenues - 3% of net win. If the service provider has no approved eligible FDC expenditures they are required to hold the FDC funds in a separate bank account and can only access the

funds once they have incurred approved eligible FDC expenditures. When a service provider has qualifying expenditures, they are entitled to withdraw those funds that have been held in the separate bank account up to amount of approved qualifying expenditures. Currently all casino service providers have approved qualifying expenditures therefore no funds are held in these separate bank accounts.

7. Are casinos allowed to make the normal capital-cost deductions that all B.C. businesses are allowed to make? That is, can they claim the capital cost allowance (CCA) against their operating revenues. If so, why then do they need FDCs?

   You would need to speak to Great Canadian for information on their tax claim entitlements. As for FDC's, this is part of BCLC's commission structure that has been in place since 1997 and it has served BCLC's business and the province very well. Tying a portion of commissions to facility development has resulted in high quality, full-service entertainment facilities that have generated almost $6 billion for government since 1997 and one of the highest rates of return for government anywhere in Canada.

8. FDCs, in theory, are there to ensure good quality gaming facilities. But isn't good quality the goal of all reputable businesses? Shouldn't that be a cost borne by the business itself?

   As outlined above, FDC is part of the overall compensation structure for casino service partners. Service Providers incur upfront capital investments in their facilities and then can submit to BCLC to qualify to earn back some of the equivalent to some of these expenses – based on the criteria. This was purposely designed in order to incentivize the service providers to build and maintain best of class facilities. In some cases, it takes over 10 years to earn the qualifying expenditures. Overall, this continues to be a highly effective business model providing high quality gaming entertainment facilities for the player and providing the Province of BC with over 56 per cent of the revenue generated by casino gambling returned to the province compared to about 35% in Quebec, Ontario and Nova Scotia.

9. Is all the money set aside for FDCs (3%?) claimed by casinos? If not, what happens to the left over money? Does the province keep it or is it rolled over into the following year?

   Based on the approved qualifying expenditures incurred by our service providers, all are receiving the FDC earned. Once there are no further eligible FDC expenditures the funds will be held by the service provider in a separate bank account until additional approved eligible expenditures have been incurred. See response to question 6.

10. What was the original capital budget for River Rock? What was the final capital budget for River Rock? If the budget increased, can we see the paperwork explaining the cost overruns, and how much BCLC paid?

The initial business plan submission for River Rock (called BridgePoint Market at the time) indicated construction costs of $60 million. This was the first casino development project to be undertaken that incorporated the new vision for BC Casinos, being a high quality full service casino that also incorporates a variety of other entertainment amenities. Once construction started, Great Canadian revised the construction budget to $135 million. It continued to increase due to both construction cost increases as well as increased scope of the project. For example, the initial project provided surface parking, but then a parkade was built into the project, which required securing additional lands. At the end of the process, other items such as prepayments for the land lease and construction delays added to the final cost which came in at about $224 million.

The $224 million is what BCLC qualified for FDC for the initial River Rock development. As of March 31, 2010, Great Canadian has earned $39,538,532 in FDC on that initial development. In 2008 they made further enhancements to the facility that they chose to earmark towards AFDC and since 2008 have earned $10,978,603 in AFDC. The total of the two is $50,517,135 in FDC/AFDC as of March 31, 2010.

Kevin Simcoe

From: Mike Wolfram
Sent: February-21-12 9:28 AM
To: Michael Graydon
Cc: Jim Lightbody; Jerry Williamson
Subject: RE: FDC/AFDC at tracks

Mike,

The balances are as follows:

Fraser Downs
- FDC s 21
- AFDC s 21

Hastings Park
- FDC s 21
- AFDC s 21

One point to note is that we have historically reminded the service providers that FDC/AFDC was not intended to as a recovery mechanism for all qualifying costs incurred , although they continue to see it as such. We have indicated that it is a component of the commission structure and there return on investment should be calculated based on the commission structure as a whole.

*** The principle we have maintained in the past is that if a facility is closed or relocated and no longer earning FDC/AFDC based on net win generated from the facility at that site then no further FDC/AFDC is earned against any remaining eligible expenditures from that site.

*** Exceptions to this rule:
Jack of Clubs Casino in Wells.
s 21

Prince George
s 21

Racetracks have always been a sort of anomaly. When s 21 first opened the commission structure was set at 18% operating and 7% FDC. This was to account for the expenditures that would be incurred for the track improvements. After a not to long of period the commission structure was changed and came in line with the current casino commission structure. Given that racetracks have been treated differently in the past and we have not indicated that they are allowed to be consolidated in the GCC group (even though we have been asked).

Options:
Consider consolidation of the two racetracks for FDC/AFDC purposes which would allow for s 21 . This would at least reduce the balances while they are still operating but certainly no where close to earning FDC/AFDC to the extent of the qualifying expenditures incurred.. It would be at no additional cost to

BCLC as we are currently paying both these FDC/AFDC amounts in commission already. Having said this, historically we have never allowed consolidation of AFDC, only FDC, as AFDC is site specific on a one time basis.

Consider racetracks receiving 5% FDC and continuing to not allow consolidation of them in the GCC group. This would keep things clean from an AFDC perspective as we would not be allowing for the consolidation of AFDC across multiple sites which may open up further issues down the road.

s 21 I am sure the question will be asked by GCC as to what happens to the outstanding balances for FDC and AFDC qualifying expenditures.

Based on past history it would be a management decision requiring board approval if we recommend that balance transfers to the GCC consolidated pool. Certainly a lot bigger number than the last time.

Mike

-----Original Message-----
From: Michael Graydon
Sent: Tuesday, February 21, 2012 8:11 AM
To: Mike Wolfram
Subject: Fw: FDC/AFDC at tracks

If we where to s 21 how would we deal with this? Mg

----- Original Message -----
From: Jim Lightbody
Sent: Tuesday, February 21, 2012 08:09 AM
To: Michael Graydon
Subject: FDC/AFDC at tracks

Mike;
We followed up on the outstanding balances of FDC/AFDC at Hastings and Fraser Downs.
s 21 ....I've asked Monica to dig into this and what our liability is.
Just a heads up in case GCGC raises it.
Jim