

# Freehills

1 November 2002

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Ms Amanda Dadd  
Australian Competition and Consumer Commission  
PO Box 119  
DICKSON ACT

By courier

FILE No: C2002/1081
DOC. D02/58540
WORLD/PRISM

Dear Ms Dadd

## **Australian Hotels Association (New South Wales) Authorisation Application A90837**

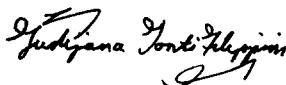
We refer to our letter to you dated 24 October 2002 enclosing the annexures to the joint submission of Tab Limited and SKY Channel Pty Limited (SKY) in response to the application for authorisation A90837 by Australian Hotels Association (NSW) (AHA), and to our discussion with you on 31 October 2002 in regard to the supply of masked copies of those annexures.

As requested, attached to this letter are masked versions of the following documents:

- Tab Limited background paper.
- Assessment of AHA calculations – Profitability of PubTAB facilities.

We will supply you with a copy of the remaining outstanding annexure to the joint submission, which relates to corrections of factual assertions made by AHA, as soon as is possible.

Yours faithfully  
Freehills  
per:



Justijana Tonti-Filippini  
Solicitor

11/11/02

## **Assessment of AHA calculations Profitability of PubTAB facilities.**

In supplementary material lodged by the AHA with the Commission, the AHA asserts<sup>1</sup> that a PubTAB outlet needed to turnover approximately \$18,000 per week in order to breakeven. Attached to the AHA's supplementary material is a schedule supporting the derivation of this amount.

Tab Limited and SKY maintain that the basis on which that calculation is conducted is fundamentally flawed in material respects, in particular:

- The calculation is an average figure. The average (mean) weekly turnover per PubTAB outlet in the financial year ended 30 June 2002 was \$19,885 - significantly above the \$18,000 per week turnover which the AHA assert is the average breakeven.
- In general, smaller hotels tend to have both lower wagering turnover and lower annual bulk beer litreage (i.e. there is a positive correlation between the size of the hotel, its annual bulk beer litreage and its wagering turnover). The AHA's calculations assume that the litreage component of the Sky Channel fee is totally independent of the wagering turnover.
- The AHA's calculations assume annual bulk beer litreage of 50,000-69,999 (i.e. 20-27 kegs per week). The average annual bulk beer litreage for NSW hotels which subscribe for the Sky Channel service disclosed to SKY (on which Sky Channel fees are based) is between 48,000 and 49,000 litres.<sup>2</sup> The adoption by the AHA in its calculations of a higher litreage increased the assumed Sky Channel fee by \$30.20 per week.<sup>3</sup>
- The AHA's calculation ignores the impact of PubTAB facilities and the Sky Channel service in assisting in attracting and retaining customers and the benefits derived by the hotels from that increased patronage through increased sales of other products (including food, gaming, beer and other beverages).

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<sup>1</sup> Paragraph 8 of the response by the AHA dated 13 September 2002 to a request for further information from the Commission dated 5 September 2002.

<sup>2</sup> The average bulk beer sales are slightly higher if NSW hotels who subscribe for Sky Channel service but do not have PubTAB outlets are included. However irrespective of whether these hotels are included or excluded for the purpose of assessing the average bulk beer litreage, the average annual bulk beer litreage disclosed to Sky Channel (and on which Sky Channel fees are based) is between 48,000 and 49,000 litres.

A number of potential factors may contribute to the difference between the average annual bulk beer sales used by Sky Channel for the purposes of calculating its fees and those adopted by the AHA, including hoteliers providing different information to Sky Channel compared to the AHA and the fact that Sky Channel's fees are calculated on the basis of historical information provided by hoteliers and is generally not revised during the term of agreements. However, in assessing the impact of Sky Channel fees, the annual bulk beer litreage adopted should be that upon which Sky Channel fees are based.

<sup>3</sup> The AHA's calculations are conducted on the basis of the Sky Channel rate card and Tab Limited PubTAB/ClubTAB commission structure applicable from 1 July 2002. The difference of \$30.20 per week is also based on the same rate card.

## **Aggregate figures**

In the financial year ended 30 June 2002:

- Tab Limited paid approximately \$22.3 million (inclusive of GST) to NSW hotels in commissions in respect of PubTAB operations; and<sup>4</sup>
- SKY received approximately \$17.4 million (inclusive of GST) in revenue from NSW hotels in respect of subscriptions for the Sky Channel service.<sup>5</sup>

## **Averages**

### ***PubTAB Commissions***

In the financial year ended 30 June 2002, the average weekly turnover of PubTAB outlets was \$19,885.

Based on the commission rates applicable from 1 July 2002, the annual commission payable by Tab Limited on this average weekly turnover would be approximately \$21,514.<sup>6</sup>

The average turnover per PubTAB outlet has decreased slightly in recent years due to the increase in the number of PubTAB outlets and the new PubTAB outlets having comparatively lower turnover.<sup>7</sup> However the rate of decline is decreasing.

The median weekly turnover per PubTAB outlet is significantly below the average (mean) weekly turnover per outlet.

### ***Fees for the Sky Channel service***

In respect of NSW hotels who currently acquire the Sky Channel service and who have a PubTAB outlet:

- the average annual fee payable to SKY is \$15,561;
- the average annual bulk beer litreage disclosed to SKY (and on which Sky Channel fees are based) is 48,288 litres; and
- the average weekly TAB turnover for the PubTAB outlets (on which Sky Channel fees are based) is

While SKY's standard form contract provides for prices to be adjusted during the term of the contract if a hotel changes its trading pattern, in practice, the fees are generally fixed at the start of the contract and are not adjusted during the term of the contract. SKY does not actively seek from hotels and clubs details on their bulk beer litreage or wagering turnover. That information is generally provided only when a contract is being signed or renewed.

SKY does not leverage its relationship with Tab Limited to verify or update TAB turnover information for NSW hotels, as to do so would result in a different treatment for NSW

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<sup>4</sup> This represents actual amounts paid during the financial year to 30 June 2002 based on commission rates then prevailing.

<sup>5</sup> This represents Sky Channel's aggregate income from all NSW hotels, including hotels who acquire the Sky Channel service but do not have a PubTAB.

<sup>6</sup> As outlined in the Tab Limited background paper, Tab Limited decreased commission rates by 0.05% of turnover with effect from 1 July 2002 consistently with the basis on which commission rates were revised in 2001. The calculations in the schedule submitted by the AHA are based on the commission rates applicable from 1 July 2002, being 1.075% where average weekly turnover is less than \$7,500 and 2.075% where average weekly commission is \$7,500 or above. These rates have also been applied for the purpose of this analysis.

<sup>7</sup> 547 PubTAB outlets operating as at 30 June 2002 had operated their PubTAB outlets since 30 June 1998 or earlier. These outlets had an average weekly turnover in the financial year ended 30 June 2002 of \$22,213, compared to \$15,882 for the 443 PubTAB outlets which commenced after 30 June 1998.

hotels compared to hotels in other States and Territories where SKY and Tab Limited do not have access to PubTAB turnover information. That SKY does not leverage Tab Limited data in this regard is apparent from the fact that the average weekly TAB turnover per outlet on which Sky Channel fees are calculated is significantly below the actual average weekly turnover of \$19,885.

As with PubTAB turnover, the median Sky Channel fees from NSW hotels with PubTAB outlets is significantly below the average (mean).

**Average Annual Profit per PubTAB outlet based on the AHA methodology**

The following tables illustrate the average annual profit derived from NSW hotels from PubTAB operations under various assumptions as to the basis on which the average Sky Channel fee is determined. For the purpose of calculation and comparison, the same methodology as adopted by the AHA for the purposes of its calculations has been applied being:

- Sky Channel fees are offset entirely against PubTAB commissions;
- no allowance is made for any benefits derived in other aspects of hotel's operations as a result of the PubTAB outlet or Sky Channel service;
- PubTAB commission rates applicable from 1 July 2002 and, except where the actual average Sky Channel fees are adopted, Sky Channel fees are calculated based on the rate card applicable as from 1 July 2002; and
- corresponding assumptions about other costs and revenue.

For the purpose of these calculation, commissions from PubTAB outlets are based on the average weekly turnover of NSW PubTAB outlets of \$19,885 per week.

	Actual average Sky Channel fees per NSW hotel with PubTAB outlet	Sky Channel fee calculated on the basis of: <ul style="list-style-type: none"> <li>• average litreage for NSW hotels with PubTABs as applied by Sky Channel (i.e 48,288 litres); and</li> <li>• weekly wagering turnover of \$19,855.</li> </ul>	Sky Channel fee calculated on basis of: <ul style="list-style-type: none"> <li>• AHA assumptions regarding litreage (i.e. 50,000-69,999 litres); and</li> <li>• Weekly wagering turnover of \$19,855</li> </ul>
Annual PubTAB commission <sup>8</sup>	\$21,514.00	\$21,514.00	\$21,514.00
Sky Channel fees	15,561.00	14,352.00	15,962.49
Paper/toner <sup>9</sup>	677.85	677.85	677.85
GST on Commission	2,151.40	2,151.40	2,151.40
<b>Average annual profit</b>	<b>\$3,123.75</b>	<b>\$4,332.75</b>	<b>\$2,722.26</b>

**Distribution of TAB commissions and Sky Channel fees in NSW hotels**

There is considerable divergence amongst NSW hotels in terms of the PubTAB commissions earned and the fees paid for the Sky Channel service.

Sky Channel's tiered rate structure tends to provide lower fees to smaller hotels. As smaller hotels in general tend to have lower wagering turnover and lower average annual

<sup>8</sup> Based on turnover of \$19,885 per week.

<sup>9</sup> Assumed to be \$13 per week being the amount assumed by the AHA for the purposes of their calculation.

bulk beer sales, there is a correlation between PubTAB commissions and Sky Channel fees.

For NSW hotels with PubTAB facilities, the median is less than the average (mean) both in terms of PubTAB commissions earned and Sky Channel fees paid.

The following tables illustrate the distribution of PubTAB commissions received and Sky Channel fees paid. To facilitate comparison between PubTAB commissions and Sky Channel fees, PubTAB commissions have been adjusted to exclude GST.<sup>10</sup>

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<sup>10</sup> The only cost in addition to Sky Channel fees and GST on commissions which the AHA includes for the purpose of their calculation is paper and toner costs associated with Daily Form Service consumables which is assumed by the AHA for the purposes of their calculation to be \$13 per week (i.e. \$677.85 per annum).

# **tab**limited

## **Tab Limited Background – attachment to Submission to the ACCC by Tab Limited and SKY Channel Pty Limited.**

**October 2002**

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## Brief Corporate History

Tab Limited was established in 1964 as the Totalizator Agency Board, a NSW statutory authority constituted under the *Totalizator (Off-Course Betting) Act 1964 (NSW)*, to conduct off-course totalizator wagering in NSW.

Initially the Totalizator Agency Board conducted wagering only on thoroughbred, harness and greyhound racing. However in 1983, the product range was expanded to include totalizator wagering on a limited range of sporting events, primarily rugby league.

In 1997, the NSW Government announced its intention to privatise the Totalizator Agency Board. As part of the privatisation process:

- the legislative regime applicable to wagering in NSW was fundamentally changed with the introduction of the *Totalizator Act 1997 (NSW)* and the repeal of the *Totalizator (Off-Course Betting) Act 1964 (NSW)*;
- Tab Limited was required to enter into a commercial agreement with the NSW racing industry in order to fund the NSW racing industry; and
- Tab Limited was granted licences to monitor gaming machines in NSW hotels and registered clubs through a "Centralised Monitoring System" (also known as a CMS), to operate a link jackpot system for gaming machines in NSW hotels and in NSW registered clubs and to own, supply and finance gaming machines in NSW hotels.<sup>1</sup>

On 25 February 1998, the Totalizator Agency Board was corporatised and became Tab Limited, a company registered under the Corporations Law, in accordance with the *Totalizator Agency Board Privatisation Act 1997 (NSW)*.

Tab Limited was privatised by way of a public float and listed on the Australian Stock Exchange Limited in June 1998. A copy of the TAB Share Offer Document and Appendices issued in connection with the privatisation of Tab Limited is attached as Annexure TAB A.

Immediately prior to privatisation, Tab Limited purchased all of the issued shares in Sky Channel Pty Limited from Publishing and Broadcasting Limited and a wholly owned subsidiary of News Limited. The acquisition of Sky Channel Pty Limited was completed in April 1998.

In April 2001, Sky Channel Pty Limited acquired 2KY Broadcasters, which broadcasts radio coverage of racing events through a commercial radio licence in Sydney and an extensive narrowcast network through-out regional and country NSW.

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<sup>1</sup> The licences were granted under Parts 11, 12 and 13 of the *Liquor Act 1982 (NSW)* and Part 12 of the *Registered Clubs Act 1976 (NSW)*. The relevant provisions are now contained in the *Gaming Machines Act 2001 (NSW)*.



### Wagering and Gaming Industry in Australia

Gambling is a highly regulated industry.

Traditionally gambling has been regulated by the States and Territories. This remains so notwithstanding the introduction of the *Interactive Gambling Act 2001(Cth)* which prohibits interactive gaming and certain aspects of interactive wagering.

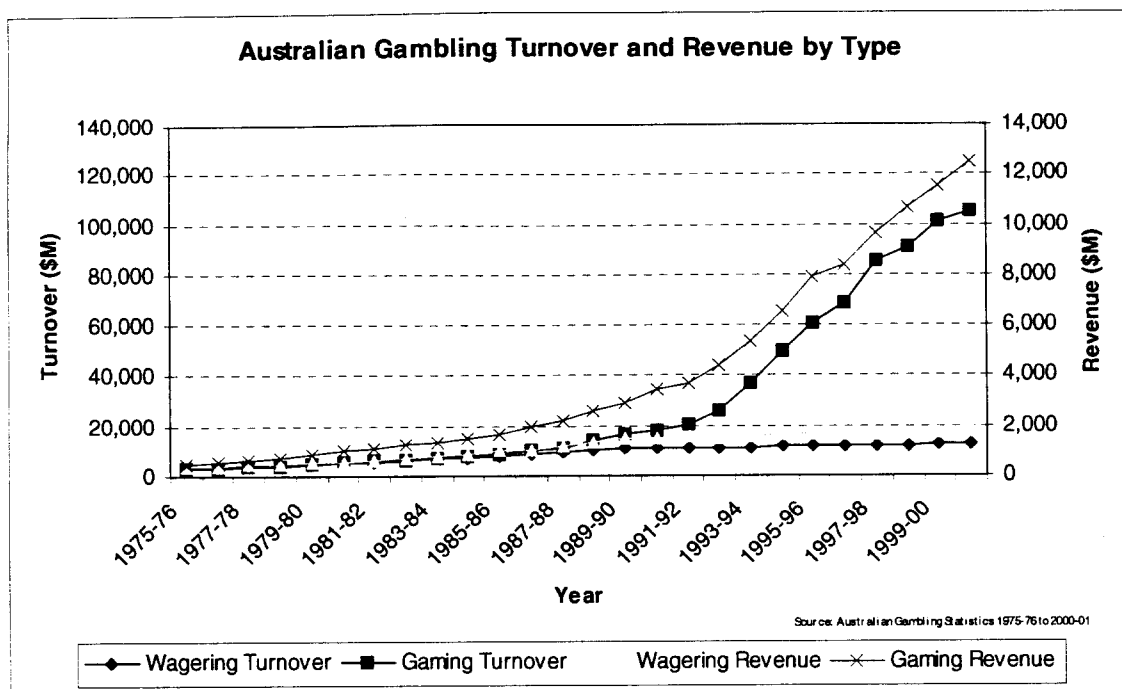
State-based regulation has resulted in differing regulatory regimes across States and Territories, which in turn has resulted in significant differences between States and Territories in relation to the development and structure of gambling activities.

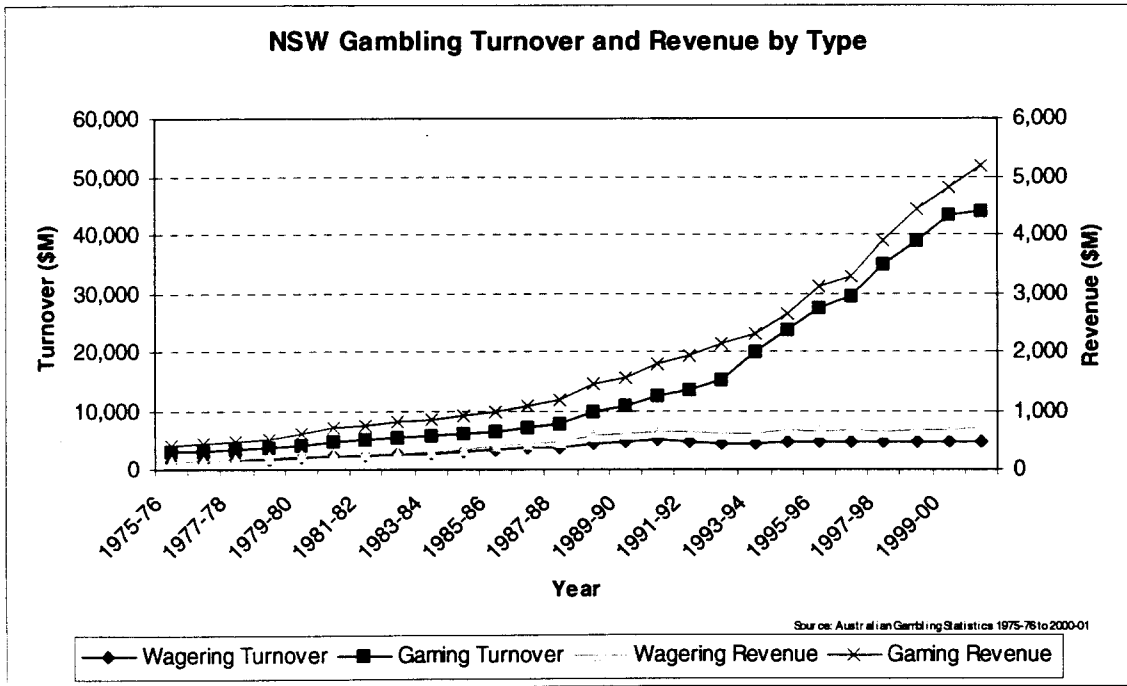
Gambling activities are categorised as either wagering or gaming.

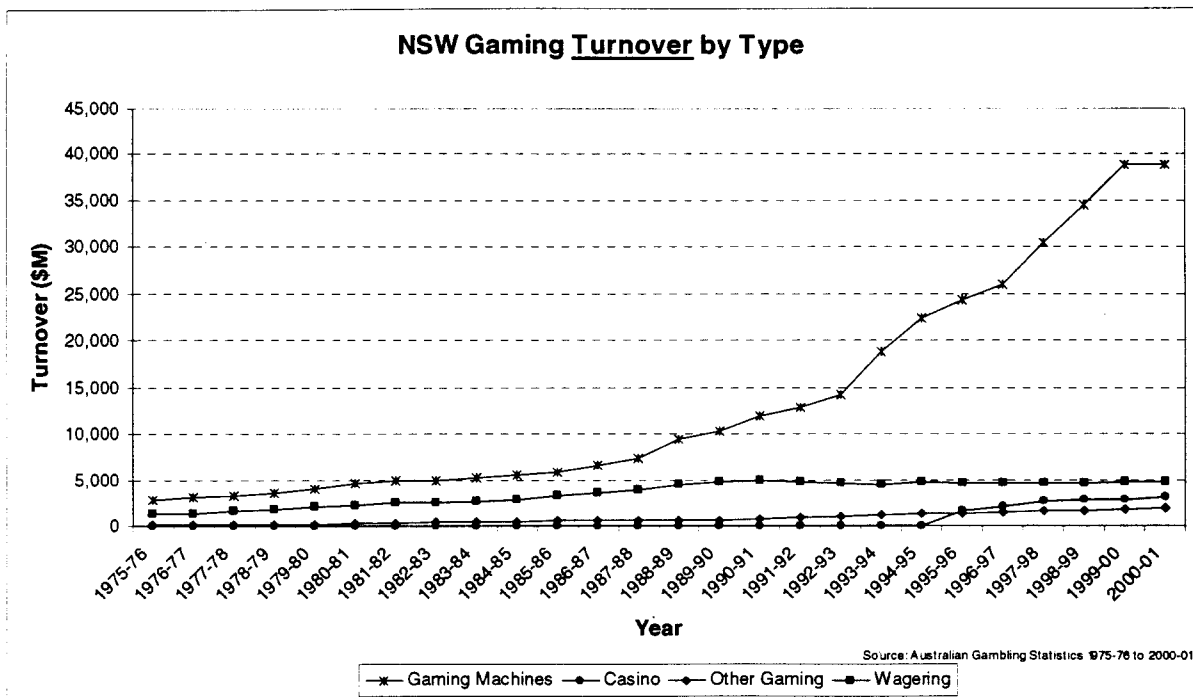
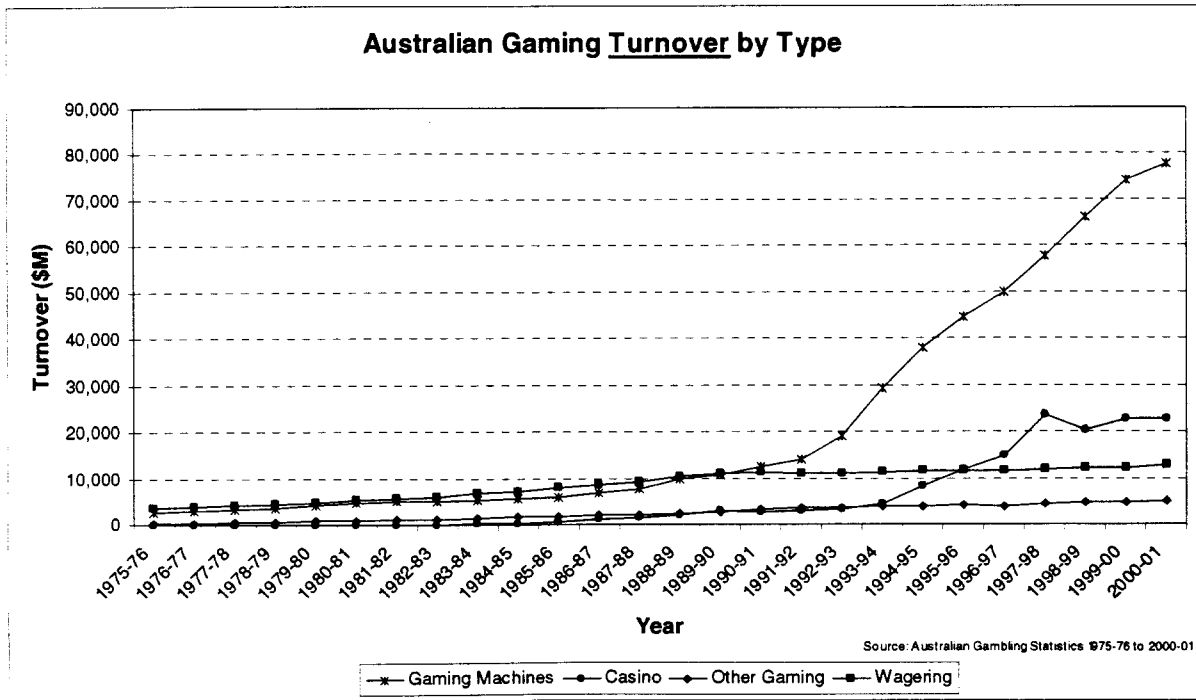
Wagering involves betting on the outcome of live events, primarily racing (thoroughbred, harness and greyhound racing) and sporting events.

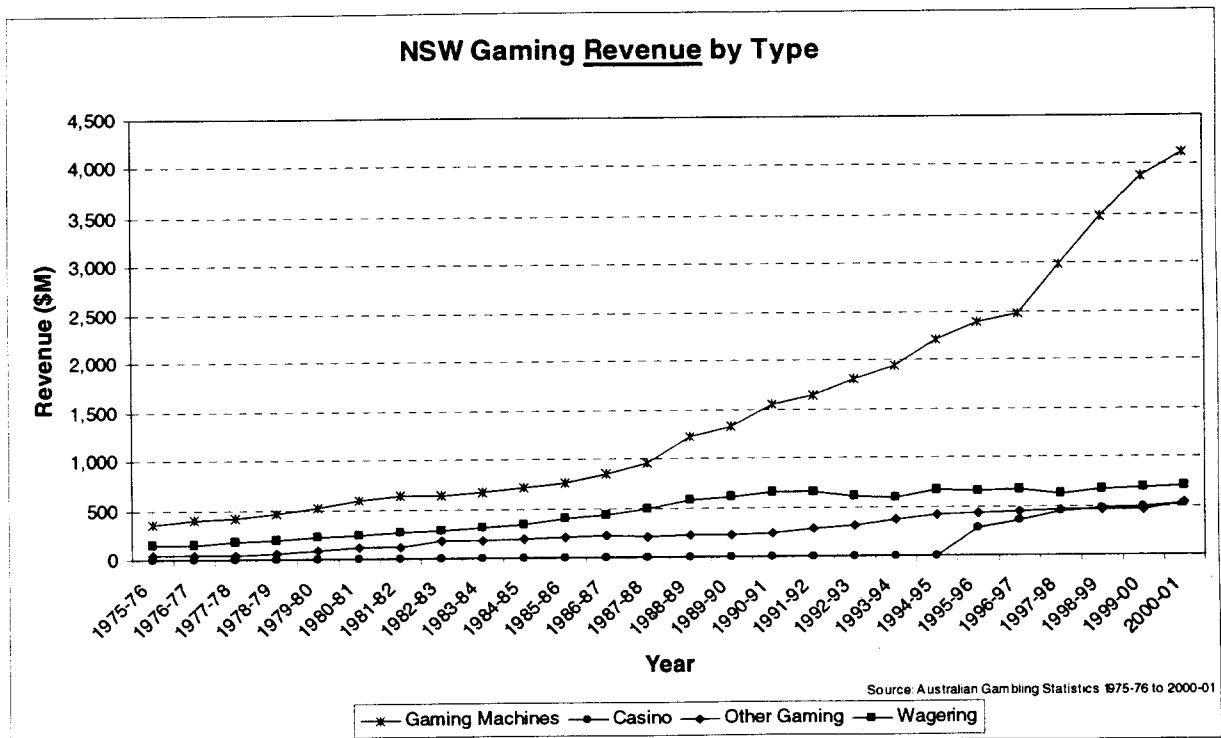
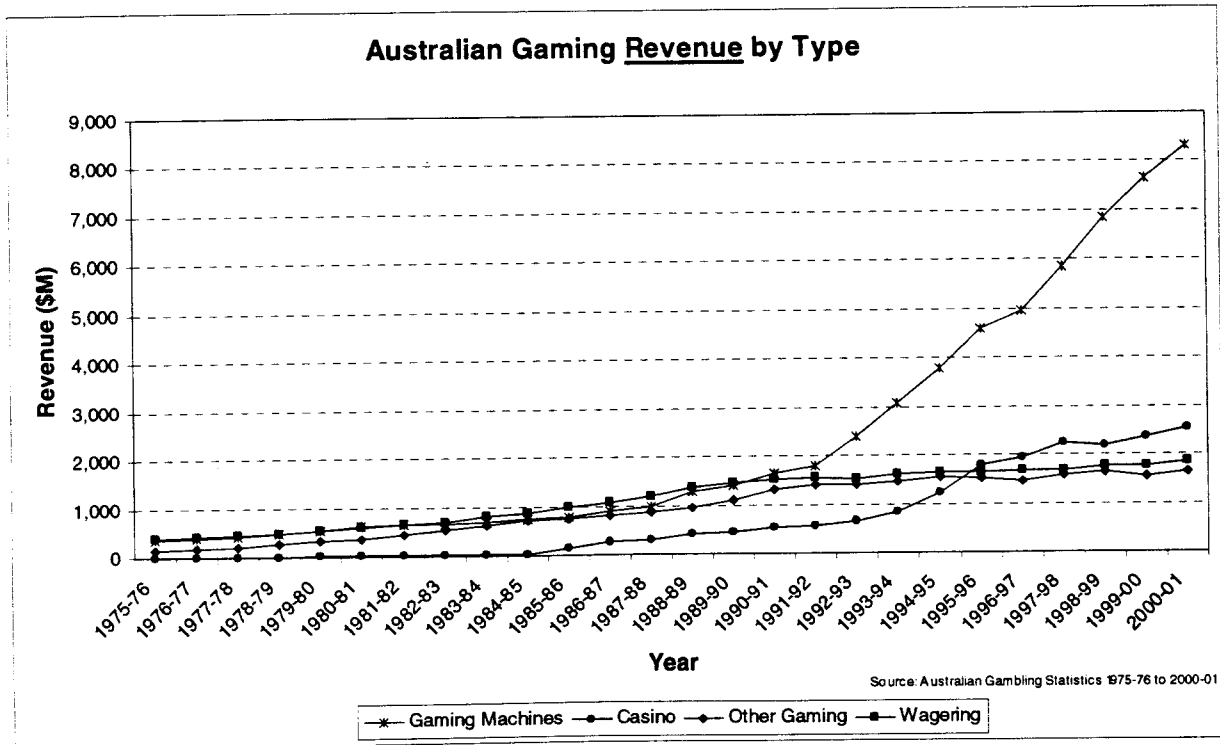
Other forms of gambling are "gaming". The principal forms of gaming in Australia are the operation of gaming /poker machines, casinos, lotteries, lotto and keno.

Nationally and in NSW gaming dominates Australian gambling, both in terms of turnover (i.e. the total amount bet by customers in a wagering event or gaming activity) and revenue (i.e. turnover less the amount paid to customers in respect of winning bets).









**Wagering**

Wagering itself is divided into totalizator wagering and fixed-odds wagering.

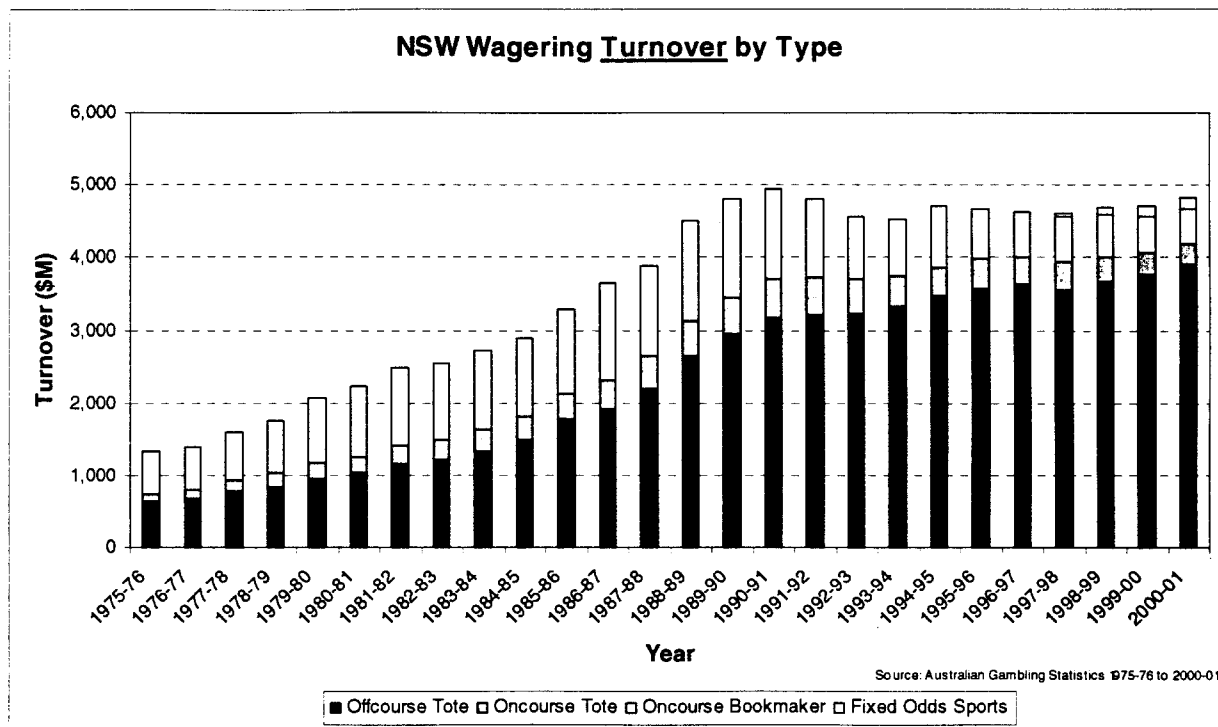
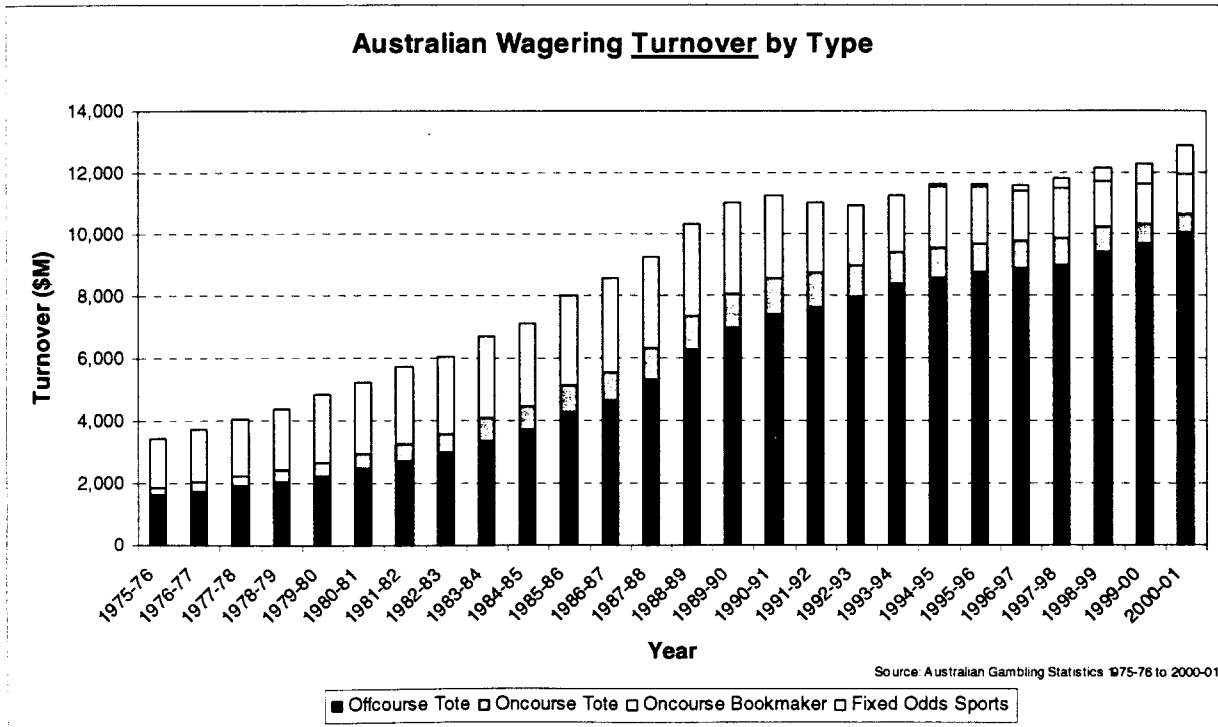
In a totalizator, also known as "pari-mutuel betting", the final odds are not calculated until after the close of betting on the relevant event (e.g. in the case of racing events, betting usually closes at the start of the race). All of the bets are consolidated or "pooled" into a totalizator pool. The totalizator operator deducts from the totalizator pool a predetermined percentage of the totalizator pool (referred to as a "commission rate" or "take-out rate") as the operator's commission.<sup>2</sup> The remainder of the totalizator pool after the deduction of the operator's commission (referred to as the "dividend pool"), is then available for distribution to people who placed bets on the totalizator. The dividend per unit of investment for each selection is calculated by dividing the number of units of investments on that selection into the total dividend pool. The odds received on a totalizator can therefore vary after a bet is placed according to other bets placed on the totalizator conducted on that event. The revenue of a totalizator operator on an event is a pre-determined percentage of the turnover on the event, with the amount of the totalizator operator's revenue being a function of the size of the totalizator pool (i.e. the turnover) and the commission rate.

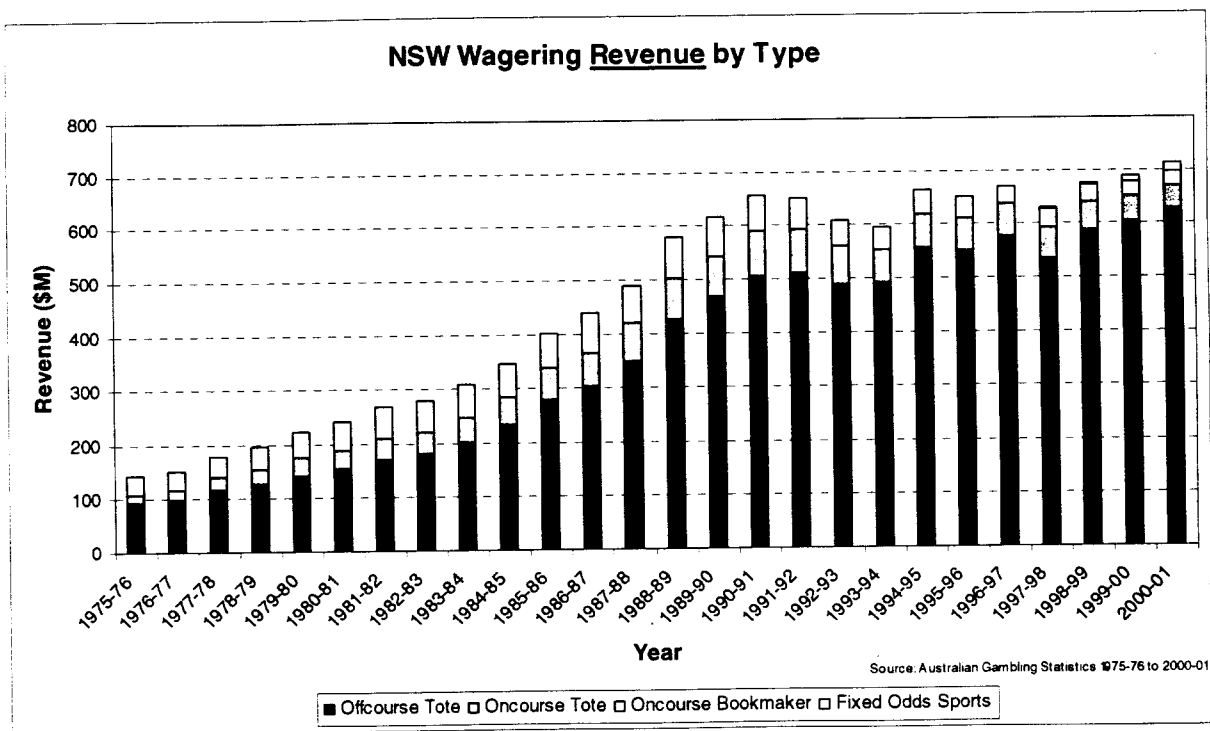
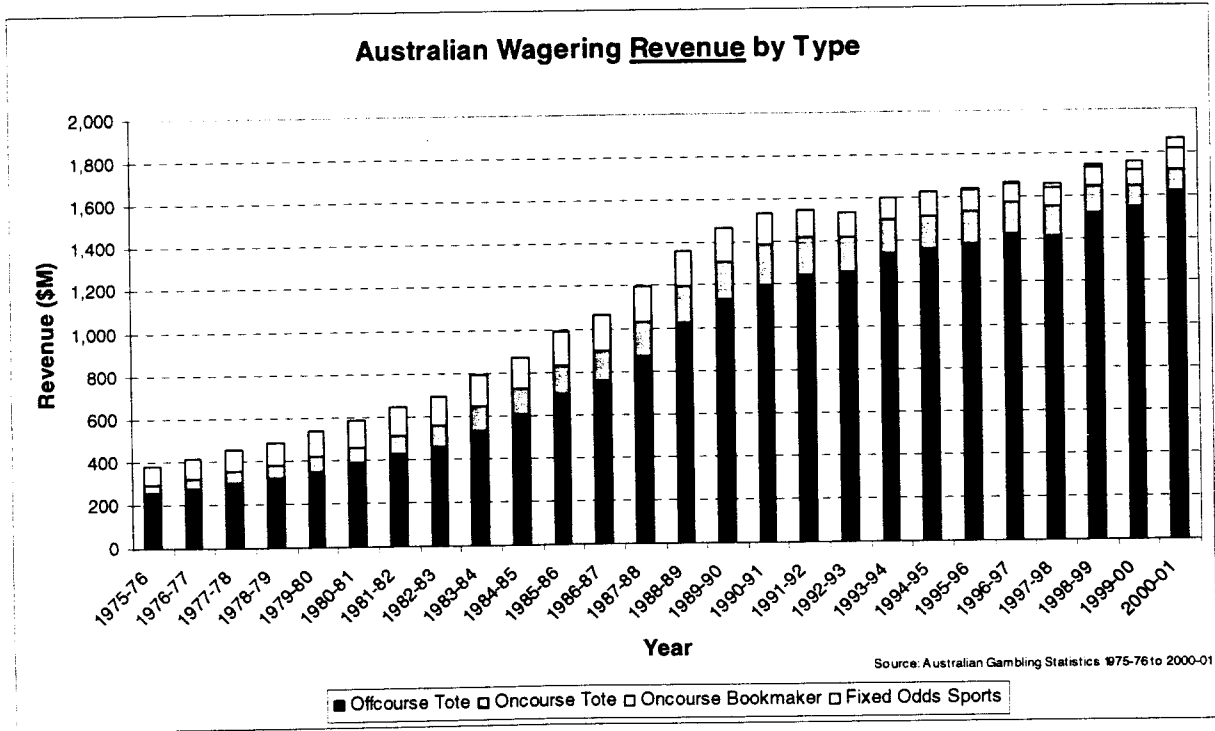
By contrast, in fixed-odds wagering, also referred to as "bookmaking", the customer is informed of the odds at the time their bet is placed and the odds on that bet do not change regardless of developments or betting patterns after the bet was placed. In fixed odds wagering, the operator's revenue depends on the outcome of the event, the management of the book of bets and the extent to which risk is laid off. Operators of fixed-odds wagering can make a loss on any event they cover.

Totalizators are the main form of wagering in Australia, comprising approximately 96% of wagering turnover in the year ended 2000-01. Approximately 94.2% of totalizator wagering turnover is "off-course" betting (i.e. the customer is not present at a racecourse when placing the bet).

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<sup>2</sup> Statutory limits are imposed on commission rates. See below for details of the limits applicable in NSW.





In each State and Territory there is one operator licensed or otherwise authorised to conduct off-course wagering. These operators are authorised to conduct totalizator wagering, although in many States legislation has recently allowed them to expand into fixed-odds wagering.

Each off-course wagering operator was originally established as a statutory authority of the relevant State or Territory known as the Totalizator Agency Board. However in recent years a number of State and Territory Governments have corporatised and/or privatised the off-course wagering operators.

Totalizator wagering can be categorised as a market making activity. As with other market making businesses (e.g. stock markets), a key feature of the attractiveness of the service is the number of people using the service. A large totalizator pool is critical to the attractiveness of a totalizator operation as, for example, in a small totalizator pool even moderate bets can affect the odds. This is evidenced by the fact that the off-course totalizator operators in all States other than NSW, Victoria and Queensland have found their totalizator pools too small to offer an attractive service to their customers, resulting in their entering into pooling arrangements with the operators in NSW, Victoria or Queensland.<sup>3</sup>

The following table sets out the current status of the off-course wagering operator in the various States and Territories and current pooling arrangements:

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Status of off-course wagering operator	Tab Limited – a listed public company	TABCorp Holdings Limited ( <b>TABCorp</b> ) – a listed public company	TAB Queensland Limited ( <b>TABQ</b> ) <sup>4</sup> – a listed public company	Government authority	Wholly owned subsidiary of TABQ	Government authority	Government authority	Wholly owned subsidiary of TABQ
Year privatised	1998	1994	1999	n/a	2002	n/a	n/a	2000
Pooling	Nil in relation to racing.  Allows pooling with TABQ for rugby league	Allows pooling from ACT, Tas and, for some pools, WA.	Pools with TABQ subsidiaries in SA and NT  Pools with Tab Limited for rugby league	Pools with TABCorp for some pools	Pools with TABQ and its NT subsidiary	Pools with TABCorp	Pools with TABCorp for some pools	Pools with TABQ and its SA subsidiary

While Tab Limited, TABCorp and TABQ all have similar names, they are totally separate listed companies. There is no connection between the three companies.

<sup>3</sup> Various pooling arrangements have been established over the years, with pooling arrangements changing as a result of factors such as regulatory issues between jurisdictions and changes in ownership of the totalizator operator (e.g. the South Australian operator prior to its privatisation pooled with TABCorp, but now pools with TABQ).

<sup>4</sup> TABQ has announced that it intends to seek approval at its annual general meeting to change its name to UniTAB Limited, consistently with the branding of the combined pools of TABQ and its subsidiaries which now operate in Queensland, South Australia and the Northern Territory under the name "UniTAB".



In addition to the off-course wagering operators, each State and Territory authorises:

- racing clubs, and in some cases commercial operators, to conduct on-course totalizators at racecourses; and
- bookmakers to conduct fixed-odds wagering. These operators are generally subject to operating restrictions, which for example require them to operate from a licensed racecourse and limit the minimum bets which bookmakers can accept from customers betting using telephone and internet. The nature and extent of these restrictions differ amongst the various States and Territories.

Off-course wagering operators can accept off-course wagers from people within the State (through outlets located in the relevant States or Territory as well as by telephone or internet) and from people interstate and overseas (through telephone or internet-accessed wagering accounts).

The off-course wagering operator in each State and Territory is commonly said to have the “exclusive” right to conduct off-course wagering in the relevant State or Territory. While this is accurate, the “exclusivity” relates to the right to maintain, and take bets through, wagering outlets in the relevant State or Territory which are not located on a racecourse. Customers in the relevant State or Territory can place bets via the telephone or internet with inter-State and international wagering operators and bookmakers licensed in the relevant State or Territory.

For example, Tab Limited is the only person authorised to conduct off-course wagering in NSW. However this restriction does not prevent, people in NSW placing bets via the telephone or internet with:

- inter-State totalizators operators (e.g. TABCorp, TABQ);
- Australian licensed bookmakers (e.g. International AllSports and Sportingbet licensed in the Northern Territory or Bill Hurley, a bookmaker licensed in NSW); and
- international wagering operators (e.g. Ladbrokes, William Hill, New Zealand Totalizator Agency Board).

Regulations restrict advertising and promotion of wagering and gaming activities, but are more restrictive for operations which are not licensed in the relevant State or Territory. In general, wagering operators are not permitted to advertise through traditional media in States and Territories in which they do not hold a wagering licence.

## Relationship Between The Wagering And Racing Industries

The racing industry<sup>5</sup> is an important part of the national economy and a major employer, particularly in regional and rural Australia. It also plays an important social role. Nationally the thoroughbred racing industry employs in excess of 249,000 people (including Full Time, Part Time and Casual Employees), with the harness and greyhound racing industry collectively employing about half that number of people.

Thoroughbred Racing Industry Employment								
Jobs	AUST	VIC	QLD	NSW	WA	SA	TAS	NT
Metro	41,649	13,418	7,506	12,048	3,796	2,793	1,232	855
Non Metro	36,106	8,812	8,261	12,705	3,015	2,721	457	135
<b>Total FTE Job Creation</b>	<b>77,755</b>	<b>22,230</b>	<b>15,767</b>	<b>24,753</b>	<b>6,811</b>	<b>5,514</b>	<b>1,689</b>	<b>990</b>
Metro	80,970	23,020	15,375	22,708	8,722	6,171	3,236	1,738
Non-Metro	168,093	41,317	39,645	58,303	13,489	11,698	2,393	1,195
<b>Total Job Creation (P/T, Casual, FTE)</b>	<b>249,063</b>	<b>64,337</b>	<b>55,020</b>	<b>81,011</b>	<b>22,211</b>	<b>17,869</b>	<b>5,629</b>	<b>2,933</b>

Figures above have been rounded to the nearest whole numbers

Source: Size & Scope of Australian Thoroughbred Racing Industry, December 2001

<sup>5</sup> In this context, the “racing industry” refers to the three codes of legalised racing events – thoroughbred racing, harness racing and greyhound racing. Other races (e.g. camels) on which betting may be permitted in certain circumstances are categorised as sporting events.

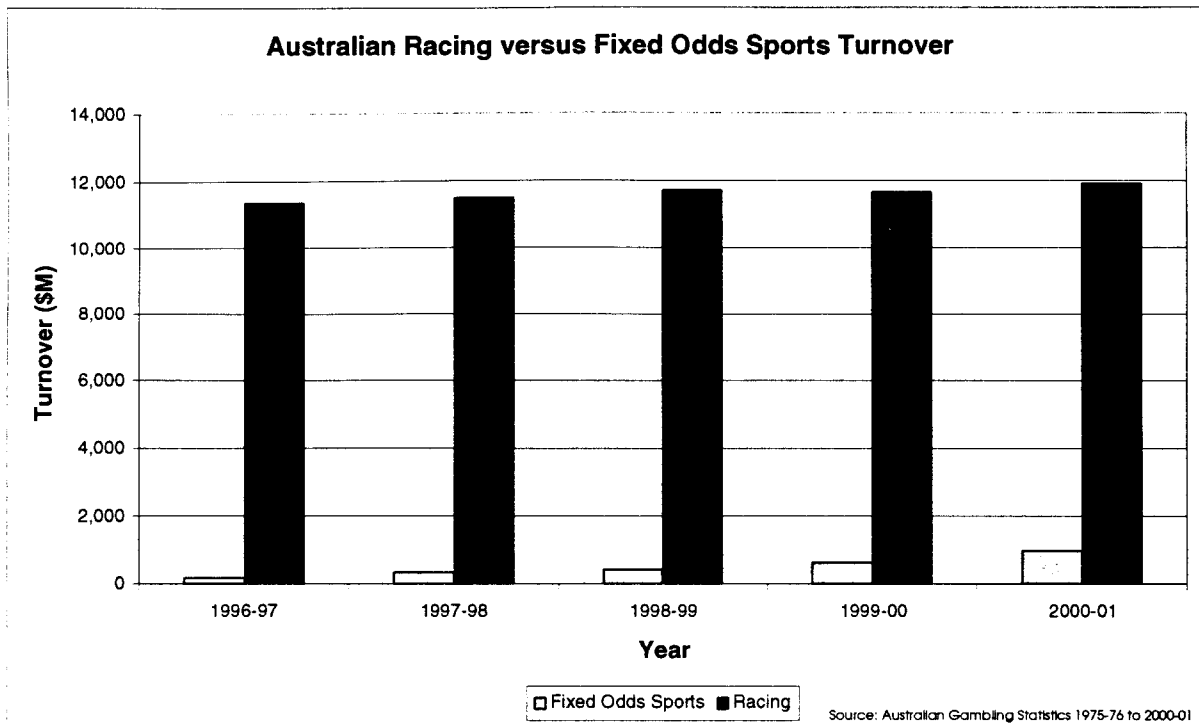
In NSW, the racing industry collectively employs almost 125,000 people.

Jobs	Thoroughbred	Harness	Greyhound	Total
Metro	13,677	2,455	2,221	18,353
Non-Metro	17,407	3,963	2,284	23,654
<b>Total FTE Job Creation</b>	<b>31,084</b>	<b>6,418</b>	<b>4,505</b>	<b>42,007</b>
Metro	21,893	5,470	6,847	34,210
Non-Metro	59,867	21,448	9,373	90,688
<b>Total Job Creation (P.T, Casual, FTE)</b>	<b>81,760</b>	<b>26,918</b>	<b>16,220</b>	<b>124,898</b>

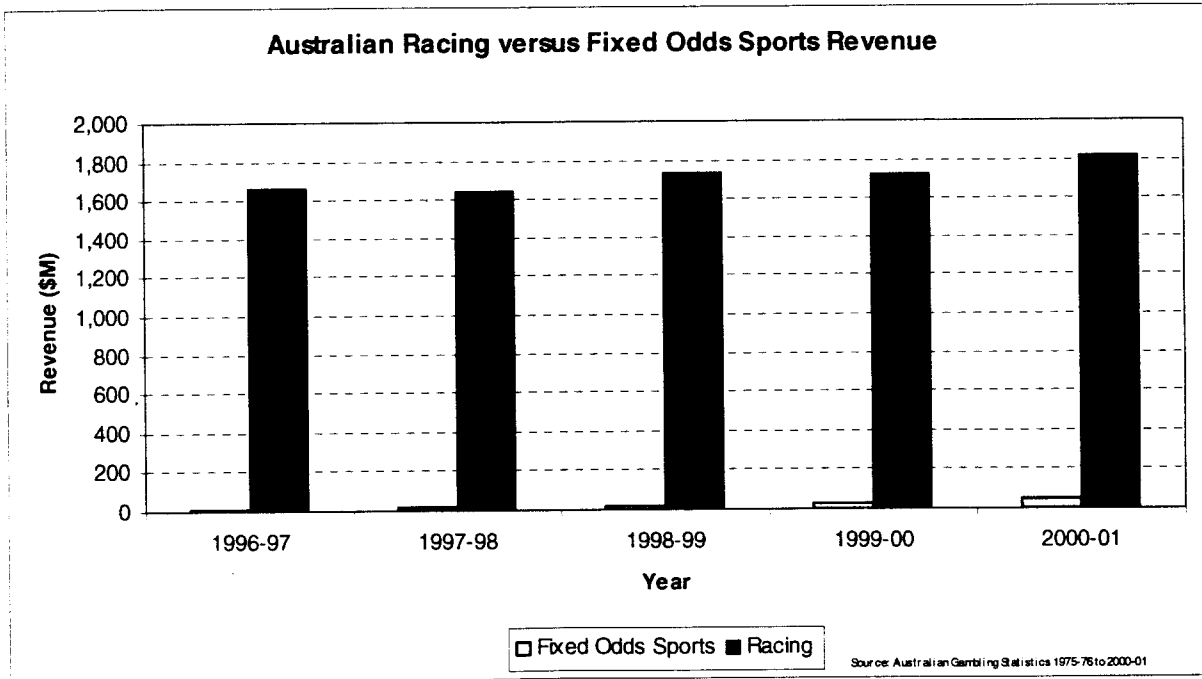
Figures above have been rounded to nearest whole number

Source: NSW Department of Gaming & Racing

Wagering in Australia is conducted primarily on the three codes of racing – thoroughbred racing, harness racing and greyhound racing. Wagering on other sporting events is relatively new in Australia<sup>6</sup> and, although growing rapidly, comprises only a small proportion of total wagering turnover.



<sup>6</sup> Unlike wagering on racing events, which is primarily totalizator wagering, wagering on sports betting is primarily fixed-odds wagering.



The predominance of wagering on racing events has resulted in an inter-dependent relationship developing between the racing industry and the off-course wagering operators in which:

- the racing industry supplies the product (i.e. stage the races) on which wagering operators conduct betting; and
- the off-course wagering operators provide the vast majority of the funding for the racing industry.

In this respect the relationship between the racing industry and wagering operators differs substantially from that which exists in relation to other sporting events as the other sporting events are generally funded through means such as tickets sales, sponsorships and media rights and do not receive funding or product fees from wagering operators who conduct betting on the event.

As wagering and racing is regulated by the States and Territories, a structure has developed under which:

- each State or Territory's off-course wagering operator funds that State or Territory's racing industry; and
- under what is known as the "Gentleman's Agreement", each State and Territory's racing industry relies solely on the funding from their own State or Territory's wagering operator and do not levy fees on the off-course wagering operators in other States and Territories in respect of wagering on their races.<sup>7</sup>

While the off-course wagering operators were government authorities, this was generally achieved by way of a statutory distribution.

In States which have privatised their off-course wagering operator, on privatisation the statutory distribution was replaced by a statutory requirement to have and given effect to commercial agreements between the off-course wagering operator and the racing industry in the relevant State or Territory. Such commercial agreements now exist in NSW, Victoria, Queensland, NT and South Australia.

The vast majority of the Australian racing industry funding is provided by the off-course wagering operators through these arrangements. For example, in respect of the year ended 30 June 2002:

- Tab Limited paid in excess of \$190 million in fees to the NSW racing industry, which represented in excess of 75% of the total funding of the NSW racing industry in that period;<sup>8</sup>
- TABCorp paid over \$252 million by way of fees to the Victorian racing industry.

Bookmakers traditionally pay limited fees to the racing industry. This has recently assumed greater significance with the growth of corporate bookmaking businesses, licensed particularly in the Northern Territory and ACT, who "free-ride" on the efforts of the racing industry in staging events to bet on and the investment of other States' off-course wagering operators in funding the racing industry. These operators pay no fees to the racing industry but target customers in other States which diverts turnover from the off-course wagering operators and therefore reduces funding to the racing industry.

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<sup>7</sup> Internationally, it is standard practice in relation to wagering on racing events (but not other sporting events) for the wagering operator to pay fees (referred to as Product Fees) to the entity which conducts racing events on which the operator conducts wagering. For totalizator wagering these product fees are generally in the order of 2.5-3% of the wagering operator's turnover on the events conducted by the relevant racing entity. Tab Limited pays product fees to international racing entities (e.g. New Zealand) in relation to the conduct of wagering on international racing. By contrast, due to the structure referred to, Tab Limited pays fees to the NSW racing industry based on its wagering activities (irrespective of the source of the product) but does not pay fees to Victorian racing bodies in respect of Tab Limited conducting wagering on Victorian racing. Similarly, TABCorp and TABQ pay fees to the Victorian and Queensland racing industries respectively but do not pay product fees to racing bodies in other States or Territories.

**Role Of Racing Media**

In addition to the racing and wagering industries, the third inter-dependent component is the specialist racing media.

Attracting wagering customers depends on the customers having accurate and timely access to racing information and to live television or audio coverage of the races. Media coverage is therefore very valuable to a wagering service.

Television coverage of races is particularly important. As wagering involves betting on live events, customers tend to want to watch the event on which they have bet. Evidence suggests that turnover on racing events is increased by approximately 40%-60% if the races are televised.

Unlike other sporting events, racing has not traditionally obtained substantial coverage on free-to-air television.

Rather free-to-air television networks have tended to televise a very limited number of selected major metropolitan thoroughbred races. This coverage is wholly insufficient for the needs of wagering operators.

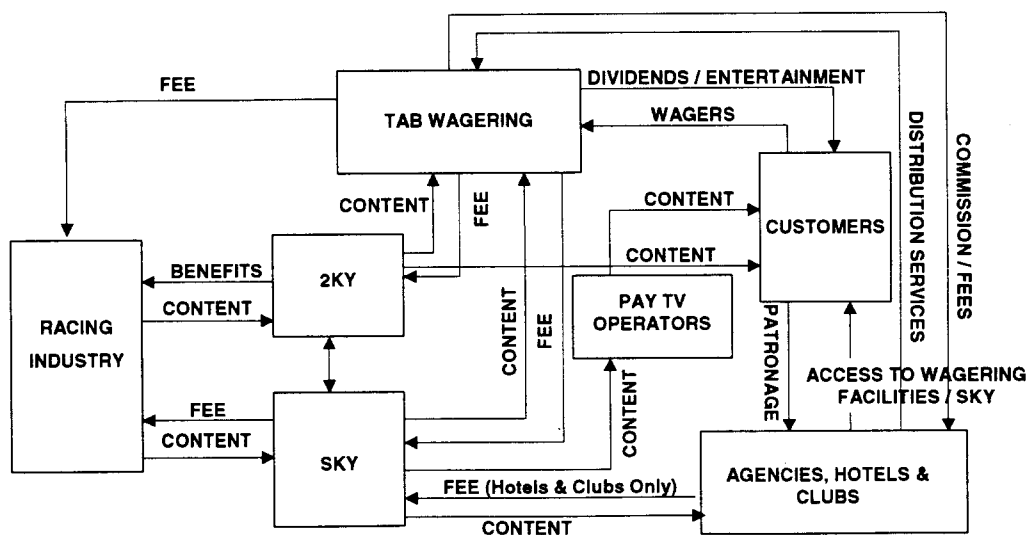
This has resulted Sky Channel Pty Limited developing from its earlier operations as a producer of general entertainment to Hotels and Clubs into a specialist racing telecaster. Sky Channel Pty Limited is the leading telecaster of racing events and racing information. Sky Channel Pty Limited operates a commercial service (branded "Sky Channel") which is telecast to subscribers in commercial premises such as hotels, registered clubs and other wagering outlets. Since its acquisition by Tab Limited, Sky Channel Pty Limited has also launched a separate service (branded "Sky Racing") which is licensed by Sky Channel Pty Limited to pay television operators such as Foxtel, Optus Vision and Austar for inclusion in a domestic pay television service to residential premises.

Each week Sky Channel Pty Limited telecasts more than 1000 races on the Sky Channel service. By way of comparison, the major capital city free-to-air television networks generally only broadcast live up to two thoroughbred races from Sydney and Melbourne and in the week ended 13 October 2002 no races were broadcast live on free-to-air television in Sydney.

In the same way as Sky Channel Pty Limited developed as a specialist telecaster of racing events, in each State and Territory there has developed a commercial radio station specialising in the radio broadcast of racing. These services have become increasingly significant to wagering operators and their customers since ABC radio ceased racing broadcasts to regional areas.

The inter-dependence between the racing industry, specialist racing media and wagering operators is illustrated as follows:

Interdependence of Racing, Media and Wagering Operators



This inter-dependence has led to a degree of vertical integration, with Sky Channel Pty Limited being owned by Tab Limited and the racing radio service in each State and Territory being owned either by that State or Territory's racing industry or off-course wagering operator.

## Regulatory Regime Regarding Off-Course Wagering And Poker Machines In NSW

### Off-Course Wagering in NSW

Off-course wagering in NSW is governed by the Totalizator Act which commenced on 6 March 1998. Principal features of the Totalizator Act relevant in the current context include:

- Only the holder of a licence under the Totalizator Act may conduct a totalizator in NSW.<sup>9</sup> However, this restriction does not prevent interstate and international wagering operators receiving bets from people in NSW through telephone or internet-accessed wagering accounts.<sup>10</sup>
- Tab Limited is entitled to be granted licences authorising it to conduct off-course and on-course totalizators on racing and sporting events.<sup>11</sup> Racing clubs are also entitled to licences to conduct at their racecourse on-course totalizators on racing events (but not sporting events).<sup>12</sup> Consistent with this requirement, Tab Limited was granted an off-course totalizator licence in consideration for a licence fee of \$303 million and an on-course totalizator licence in consideration for a licence fee of \$5 million. Both licences have a term of 99 years.<sup>13</sup> Copies of these licences are attached as Annexure TAB B.
- Other than Tab Limited's totalizator licences and the on-course licences granted to racing clubs, no other totalizator licence may be issued under the Totalizator Act until March 2013 unless Tab Limited's licences are cancelled or surrendered.<sup>14</sup>
- Where Tab Limited conducts an off-course totalizator on a racing event, any amount bet on an on-course totalizator conducted by a racing club on that racing event is received by the racing club as an agent for Tab Limited. Bets placed with the racing club in these circumstances are collected and transferred into the totalizator conducted by Tab Limited.<sup>15</sup>
- Other than racing clubs in respect of their on-course totalizator licence, any holder of a totalizator licence must have and give effect to commercial arrangements with an entity nominated by certain major racing clubs as the "racing industry" for the purpose of the licence.<sup>16</sup> Consistent with that requirement, Tab Limited (then the Totalizator Agency Board) entered into the "Racing Distribution Agreement" with NSW Racing Pty Limited, the NSW Thoroughbred Racing Board, Harness Racing New South Wales and the Greyhound Racing Authority. The Racing Distribution Agreement commenced on 6 March 1998. A copy of the Racing Distribution Agreement, and subsequent amending agreements, is attached as Annexure TAB C.

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<sup>9</sup> Totalizator Act sections 7-9.

<sup>10</sup> There are however prohibitions in some States against residents of the relevant State betting with wagering operators not licensed in Australia on Australian racing events. However in a practical sense these restrictions are extremely difficult to enforce and have had limited effect.

<sup>11</sup> Totalizator Act sections 14 and 15(1).

<sup>12</sup> Totalizator Act section 15(2).

<sup>13</sup> The licence have a term of 99 years. However the "exclusivity period" applies only for the first 15 years of the licence terms.

<sup>14</sup> Totalizator Act sections 14(2) and (4) and 15(3), (5) and (6). The "operative date" for the purpose of these sections was declared by the Minister as 6 March 1998.

<sup>15</sup> Totalizator Act section 17(3) and (4).

<sup>16</sup> Totalizator Act sections 21A and 43(2).

- Statutory exemptions from the Trade Practices Act were granted in respect of the grant of Tab Limited's totalizator licences and racing clubs' on-course totalizator licence, conduct authorised or required under those licences and entering into, and giving effect to, commercial arrangements between totalizator licensees and the NSW racing industry required under the Totalizator Act (and certain ancillary arrangements) where those arrangements have been approved by the Minister by order published in the Gazette.<sup>17</sup> Those arrangements were the subject of a submission by the NSW Government to the National Competition Council as provided for under the Competition Principles Agreement.
- The Minister may approve a totalizator licensee conducting wagering activities other than totalizators (e.g. fixed odds wagering) on racing and sporting events.<sup>18</sup> The Minister has authorised Tab Limited to conduct fixed-odds wagering on a variety of sporting events and on a limited range of racing events.
- Totalizator licensees must generally determine the rules of wagering pursuant to which their totalizators will be conducted, with the approval of the Minister. During the first 15 years of the totalizator licences, racing clubs are not entitled to make rules of wagering and must conduct their on-course totalizators in accordance with Tab Limited's rules of wagering except to the extent that the Minister determines otherwise.<sup>19</sup>
- Totalizator licensees are entitled to retain fractions. They are also entitled to retain any amounts declared as dividends on winning bets which the customer has not claimed within 12 months after the happening of the event on which the bet was placed.<sup>20</sup>
- Totalizator licensees are given flexibility in determining commission rates provided that:
  - the commission deducted from any totalizator pool (exclusive of fractions) must not exceed 25% of the total amount wagered in the totalizator pool; and
  - the total commission (exclusive of fractions) deducted in any financial year must not exceed 16% of the total amount of wagers received by the totalizator licensee in that year.<sup>21</sup>
- A tax of 28.2% is payable by the totalizator licensee to the NSW Government on wagering revenue, exclusive of unclaimed dividends. The rate of tax on components of wagering revenue may be reduced below 28.2% by order of the NSW Governor.<sup>22</sup>

The Racing Distribution Agreement is a critical document to Tab Limited and the NSW racing industry and an integral part of the regime established in connection with the privatisation of Tab Limited. While the Racing Distribution Agreement is a lengthy and complex document, it essentially provides for:

- the NSW racing industry to conduct a minimum number of thoroughbred, harness and greyhound races in NSW in each calendar year. Provided the races meet the minimum requirements of the Racing Distribution Agreement, the NSW racing industry determines the scheduling of events but must consult with Tab Limited;
- Tab Limited to conduct off-course totalizators on a minimum program of thoroughbred, harness and greyhound races in NSW in each calendar year. Tab Limited must conduct off-course totalizators on the minimum programme of races specified by the NSW racing industry but otherwise determines the races on which it conducts off-course totalizators but must consult with the NSW racing industry;<sup>23</sup>

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<sup>17</sup> Totalizator Act section 17A. The Minister has made orders under section 17A(2) approving the Racing Distribution Agreement, and certain amendments to that agreement, and arrangements for the distribution amongst the racing industry of funds received from Tab Limited under the Racing Distribution Agreement.

<sup>18</sup> Totalizator Act section 13.

<sup>19</sup> Totalizator Act sections 53-58.

<sup>20</sup> Totalizator Act section 75.

<sup>21</sup> Totalizator Act section 69.

<sup>22</sup> Totalizator Act section 70.

<sup>23</sup> A number of press articles in recent times, including an article attached to supplementary material lodged with the Commission by the AHA, refer to the reduction in the number of "non-TAB" race meetings, particularly in regional and rural areas. The term "non-TAB" meetings is a legacy from the pre-privatisation era when meetings on which an off-course totalizator was conducted were referred to as "TAB meetings" and meetings on which no off-course totalizator

- Tab Limited to pay the following fees to the NSW racing industry:
  - a Product Fee of 21.64% of Tab Limited's totalizator revenue from totalizators conducted by Tab Limited under a licence granted under NSW legislation. This applies to totalizators conducted under a NSW licence irrespective of the nature of the event or location of the event on which the totalizator is conducted (e.g. the Product Fee is payable equally in respect of a totalizator conducted on a race in NSW, a race in Victoria or a rugby league match played in New Zealand);
  - a "Wagering Incentive Fee" of 25% of the "Wagering Earnings" of Tab Limited in respect of its wagering activities conducted under a licence granted under NSW legislation; and
  - a "Gaming Incentive Fee" of 25% of "Earnings" from the businesses conducted by Tab under NSW linked jackpots licences, NSW CMS licence or NSW licences to provide or finance gaming machines; and
- the NSW racing industry, in certain circumstances, to have an option to invest in new gaming or wagering businesses which Tab Limited may establish or acquire.

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was conducted were referred to as "non-TAB meetings". This terminology is somewhat misleading as the racing industry, not Tab Limited, is responsible for scheduling and approving race meetings, as well as the conduct of race meetings. Tab Limited only determines whether or not it will conduct an off-course totalizator on the relevant meetings. This is clear from clause 5 of the Racing Distribution Agreement. The decline in the number of "non-TAB" race meetings has resulted, not from any act or decision of Tab Limited, but from decisions by racing industry bodies.

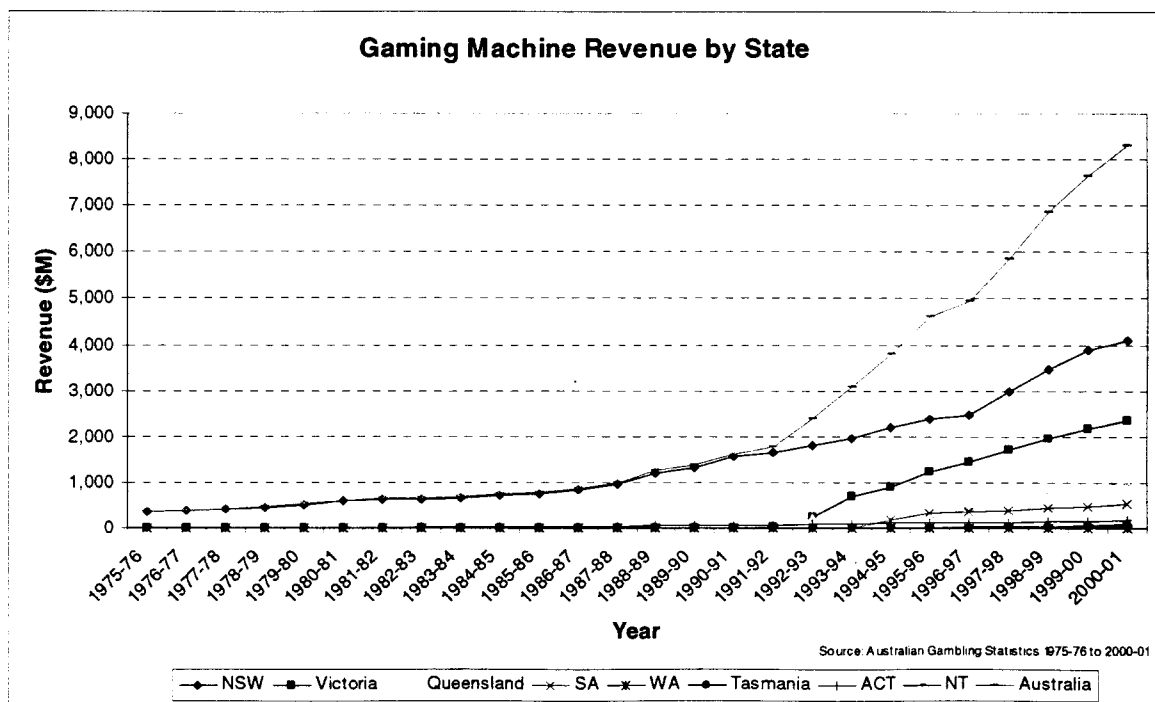
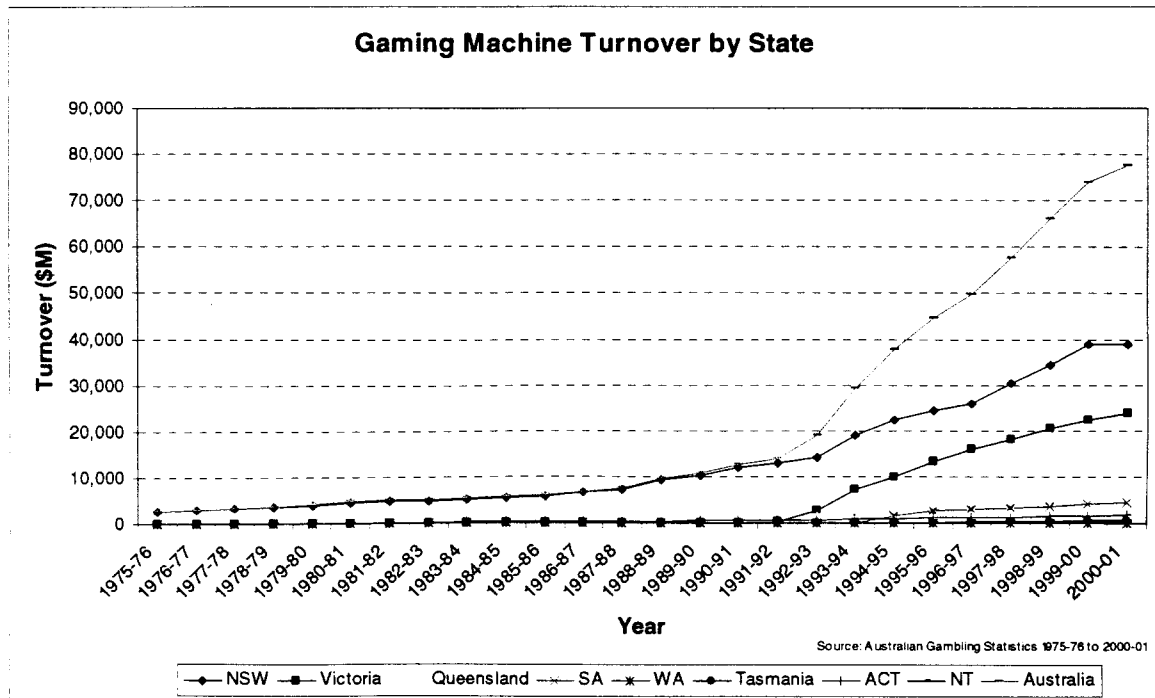
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**Poker Machines**

Electronic gaming machines have operated in NSW registered clubs since 1956 and in NSW hotels since 1985. Legislative changes, particularly since 1997, have resulted in significant growth in the number of electronic gaming machines, and turnover and revenue from electronic gaming machines in NSW hotels.

There are currently more than 100,000 electronic gaming machines operating in NSW – providing NSW with one of the highest number of electronic gaming machines in the world on a per capita basis.<sup>24</sup>



24

"Gaming machines" in this context refer to poker machines and similar electronic gaming machines.