

**Tab Limited**

and

**SKY Channel Pty Limited**

**Submission in response to  
application for authorisation  
A90837 by Australian Hotels  
Association (NSW)**

**23 October 2002**

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## 1 Overview of submission

Tab Limited (**Tab Limited**) and SKY Channel Pty Limited (**SKY**) make this submission in response to application for authorisation A90837 made to the Commission by Australian Hotels Association (NSW) (**AHA**) on 17 July 2002 (the **Application**).

AHA applies for authorisation to negotiate collectively with Tab Limited and SKY on behalf of its member hotels. The Application extends to:

- (a) the collective negotiation of contractual terms of supply and acquisition, including prices, with Tab Limited and SKY; and
- (b) primary boycott activity, allowing AHA member hotels collectively to agree to withdraw services as a negotiation strategy, seven days after the “breakdown” of negotiations.

Tab Limited and SKY oppose the grant of authorisation.

The conduct for which authorisation is applied is revealed, by close examination of the Application and associated submissions and supporting material, to be no more than “naked restraints”, ie:

- Price fixing in respect of the supply by AHA member hotels to Tab Limited of PubTAB agency services and in respect of the acquisition by AHA member hotels from SKY of SKY Channel services.

No other objective or outcome claimed in the Application survives examination.

- Primary boycotts of Tab Limited and SKY in furtherance of the price fixing.

Price fixing and primary boycotts are anti-competitive conduct of the most serious kind, requiring substantial public benefits to justify authorisation.<sup>1</sup>

The terms of the contract, arrangement or understanding pursuant to which the conduct would be engaged in are unclear. The AHA member hotels who would participate in any collective bargaining group, the likely outcomes, and the effects on output, are all uncertain. The objectives – price fixing and primary boycotts – are clear, but the claimed benefits are illusory.

The Application bears no comparison with authorisation determinations by the Commission in the dairy farming, chicken growing and other industries, because:

- Tab Limited’s PubTAB commissions are a minor and ancillary component of hotel income;
- SKY’s Sky Channel fees are a minor and ancillary component of hotel overheads;
- there is here no deregulation, restructuring or transition of an industry – indeed, the conduct if authorised would interfere with existing, legally binding, contractual relationships;

<sup>1</sup> TAB and SKY note the Commission’s view in the Anaesthetist’s Determination A30195 at page 24 that “*agreements or arrangements between competitors in relation to prices [are] amongst the most serious forms of anti-competitive conduct and highly likely to result in a substantial lessening of competition.*”

- the counterparties to the underlying contracts which are the target of the conduct, ie Tab Limited and SKY, strenuously oppose the conduct.

If AHA were to obtain through collective negotiations increases in Tab Limited's commissions or reductions in SKY's fees, it would constitute a mere transfer to AHA member hotels, directly from Tab Limited and SKY and indirectly from the NSW racing industry, and to a lesser extent, from the racing industry each other State and Territory. Such transfers would likely inure to larger, "infra-marginal" hotels, and are not public benefits.

Further, such transfers would likely lead to:

- reductions in the output of wagering services, as Tab Limited ceases acquiring PubTAB agency services from some marginal hotels and moves to less efficient channels of distribution;
- other marginal hotels receiving less advantageous terms from Tab Limited;
- customers being deprived of access to wagering at their preferred outlets or through their preferred distribution channel;
- reductions in the output of racing coverage as SKY reduces the fees it pays to racing clubs for broadcast rights; and
- ultimately, reductions in the output of racing.

AHA claims that the transfers will be passed through to consumers in price reductions, but has not explained how the pass through would occur nor what incentives there are for the pass through to occur. In fact it is clear there would be no pass on to consumers, because the commissions and fees are a minor and ancillary part of hotels' total income and overheads. Experience in the hotel industry at the time of the introduction of the "A New Tax System" shows that prices are "sticky downwards", even in the face of much more direct impacts on costs and the sanction of penalties.

There is no evidence for the claimed reduction in transactions costs, either for AHA member hotels or for Tab Limited and SKY. Tab Limited and SKY already use standard form contracts and consult regularly with AHA. The use of standard form contracts is justified by the nature of the relevant industries and is particularly efficient in the case of Tab Limited's arrangements with hotels. Perversely, AHA's conduct is more likely to increase transaction costs.

Claims that the proposed conduct would affect the viability of rural and regional hotels, increase the efficiency of the industry, promote industry harmony, reduce the potential for unconscionable conduct, and lead to "equity", are insupportable in principle and unsupported by any evidence.

The relevant counterfactual for the authorisation tests in this case is the current situation or the status quo, because there is no evidence or likelihood that, absent the proposed conduct, there would be any relevant change to current arrangements or practices. When compared with this counterfactual, the proposed conduct is likely to result in net detriments, including:

- reductions in the output of wagering and racing services;
- reductions in amenity for customers; and
- increased transaction costs for all parties.

Accordingly, the Commission should make a determination dismissing the Application.

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## **2 Introduction**

### **2.1 Submission**

This is a joint submission by Tab Limited and SKY opposing the Application. The submission is structured as follows:

- Brief background on Tab Limited's history and pricing.
- Brief background on SKY's history and pricing.
- A summary of the conduct and issues associated with the uncertain details of the conduct.
- Tab Limited's and SKY's responses to the arguments in support of authorisation made by AHA in the Application and subsequent meetings and correspondence with the Commission.
- A summary of an economic analysis of the racing and wagering industries and the merits of the Application by NECG (the report by NECG is provided as a separate annexure).

### **2.2 Annexures**

The submission is supported by a number of separate annexures:

- Detailed background information on Tab Limited
- Detailed background information on SKY
- The NECG report on the economic analysis of the racing and wagering industries and the merits of the Application
- Responses to assertions by AHA in the Application and subsequent meetings and correspondence with the Commission as to the turnover required for a PubTAB to be viable for the hotel.

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## 3 Tab Limited

### 3.1 Tab Limited 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. In 1997, the NSW Government announced its intention to privatise the Totalizator Agency Board. 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.

Immediately prior to privatisation, Tab Limited purchased all of the issued shares in SKY.

Tab Limited is Australia's largest wagering organisation. It conducts:

- totalizator wagering on Australian and international racing and on the National Rugby League competition;
- fixed-odds wagering on a range of sporting events including rugby league, cricket, soccer, rugby union, golf, tennis, boxing, Australian Rules football, motor sports and basketball; and
- fixed-odds wagering on major racing events.

A copy of Tab Limited's Annual Report for the year ended 30 June 2002 is attached as Annexure "TAB A" to the detailed background paper on Tab Limited.

### 3.2 Wagering and gaming

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

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.

### 3.3 Background to totalizators in Australia

A totalizator is one form of wagering, the other being fixed odds betting (also known as "bookmaking"). These are discussed in detail in the separate Tab Limited background paper. 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).

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 and 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. The following table sets out the status of the off-course wagering operator in each state:

State	Status of off course wagering operator
NSW	Tab Limited – a listed public company
Victoria	TABCORP Holdings Limited ( <b>TABCORP</b> ) – a listed public company
Queensland	TAB Queensland Limited ( <b>TABQ</b> ) – a listed public company
Western Australia	Government authority
South Australia	Wholly owned subsidiary of TABQ
Tasmania	Government authority
Australian Capital Territory	Government authority
Northern Territory	Wholly owned subsidiary of TABQ

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

The off-course wagering operators can accept off-course wagers from people within the State (through outlets located in the relevant State 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 also with bookmakers licensed in the relevant State or Territory.

### 3.4 Relationship between the racing and wagering industries

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>2</sup> and, although growing rapidly, comprises only a small proportion of total wagering turnover.

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:

<sup>2</sup> Unlike wagering on racing events, which is primarily totalizator wagering, wagering on other sports is primarily fixed-odds wagering.

- the racing industry supply 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.

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

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

The vast majority of Australian racing industry funding is provided by the off-course wagering operators. 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>3</sup>.

### 3.5 Regulatory regime regarding off course wagering in NSW

#### (a) Totalizator Act

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

- Only the holder of a licence under the Totalizator Act may conduct a totalizator in NSW. However, this restriction does not prevent interstate and international wagering operators receiving bets from people in NSW through telephone or Internet accessed wagering accounts.
- Tab Limited was granted an off-course totalizator licence in consideration of a licence fee of \$303 million and an on-course totalizator licence in consideration of a licence fee of \$5 million. Both licences have a term of 99 years.
- No other totalizator licence may be issued under the Totalizator Act until March 2013 (other than Tab Limited's totalizator licences and the on-course licences granted to racing clubs) unless Tab Limited's licences are cancelled or surrendered.
- Any holder of a totalizator licence (other than racing clubs in respect of their on-course 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. This, in effect, prevents NSW licensed totalizator operators "free riding" on the racing industry. Tab Limited has entered into the "Racing Distribution Agreement" with NSW Racing Pty Limited (**NSW Racing**), the NSW Thoroughbred Racing Board, Harness Racing New South Wales and the

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<sup>3</sup> Sky Channel Pty Limited also provided a further proportion of the NSW racing industry's total funding by way of television rights fees.



Greyhound Racing Authority. The Racing Distribution Agreement commenced on 6 March 1998.

**(b) Racing Distribution Agreement**

The Racing Distribution Agreement is a critical document to Tab Limited and the NSW racing industry. The Racing Distribution Agreement essentially provides for the following:

- The NSW racing industry is to conduct a minimum number of thoroughbred, harness and greyhound races in NSW in each calendar year.
- Tab Limited is to conduct off-course totalizators on a minimum programme of thoroughbred, harness and greyhound races in NSW in each calendar year.
- Tab Limited is to pay the following fees to NSW Racing:
  - 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;
  - 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 Limited under NSW linked jackpots licences, a NSW CMS licence and NSW licences to provide or finance gaming machines.
- NSW Racing, in certain circumstances, has an option to invest in new gaming or wagering businesses which Tab Limited may establish or acquire.

**3.6 Distribution network**

Tab Limited's wagering distribution network comprises:

- agencies;
- PubTAB/ ClubTAB;
- telephone betting (PhoneTAB);
- Internet betting (RaceTAB and SportsTAB); and
- "on course" facilities.

As at 30 June 2002, Tab Limited had a total of 1930 wagering outlets throughout NSW, comprising 336 agencies, 990 PubTABs and 604 ClubTABs. Some 47% of these outlets are located outside the Sydney metropolitan area.

While the total number of outlets has increased by approximately 32% since privatisation, the mix of outlets has also changed substantially with the closure of all Tab Limited owned branches, a rationalisation of agencies and a substantial increase in the number of PubTAB and ClubTAB outlets.

### **3.7 PubTABS**

#### **(a) Generally**

A PubTAB is operated in the licensed premises from which the hotel conducts its ordinary business activities and is conducted as an ancillary activity to the main business of the hotel. PubTABS assist in attracting and retaining customers in a hotel.

The fittings and fixtures within the premises for the PubTAB are provided by the hotel. While Tab Limited has the right to approve proposed fittings and fixtures, the scale and nature of fittings and fixtures are determined by the hotel. As a result PubTAB outlets differ markedly, from large self-contained rooms to relatively small areas not distinguished from the bar and other areas of the hotel.

A PubTAB operator receives a commission based on turnover of the PubTAB. This is discussed further below at paragraph (c). Tab Limited also supplies and maintains all of the equipment necessary to conduct the wagering service and bears operating costs of communications, tickets, consumables, race lists and formguides.

Between 30 June 1998 and 30 June 2002, Tab Limited commissioned 464 new PubTABS. In that time, 60 hotels have ceased their PubTABS, a nominal number of which have ceased their PubTABS as a result of failure properly to account to Tab Limited for amounts owing to Tab Limited in respect of the PubTAB operation and the balance of which have elected to relinquish their service, usually as a result of a change in ownership or management of the relevant hotel.

Despite this expansion, Tab Limited continues to receive on a continual basis requests from hotels for PubTAB facilities. Given the capital investment by Tab Limited required for a PubTAB outlet, a PubTAB outlet requires turnover of approximately \$7,500 per week to provide Tab Limited with a satisfactory return based on the current commission structures, capital and operating costs. Given the demand, Tab Limited is actively considering a number of potential options which may enable it economically to provide wagering facilities through outlets which generate lower turnover.

#### **(b) Contractual arrangements in relation to PubTABS**

Tab Limited uses a standard form agreement for all PubTAB outlets. The agreement used for PubTABS is identical to that used for ClubTABS. For large numbers of outlets, a standard form agreement is important. This is particularly so in a highly regulated industry such as wagering, where uniformity of terms is an important compliance issue.

Following privatisation, Tab Limited continued to use the same standard form of agreement for its PubTABS as it had used for many years as a government authority.

The terms of the standard form agreement were revised in 2001. Tab Limited believed that endorsement by AHA would assist Tab Limited in having individual hotels accept the new form of agreement. Accordingly, Tab Limited engaged in an extensive consultation process with AHA over many months in relation to the

new agreement.<sup>4</sup> Copies of correspondence reflecting the consultation process are set out in Annexure “TAB I” to the detailed background paper on Tab Limited.

As is apparent from the correspondence in Annexure “TAB I, Tab Limited made a number of changes to the structure and terms of the new agreement as a result of comments and discussions with AHA. During that process, AHA expressly acknowledged and accepted that Tab Limited would apply a standard form of agreement to all PubTAB outlets.<sup>5</sup>

A copy of the current standard form agreement used by Tab Limited for PubTAB and ClubTAB outlets is contained in Annexure “TAB G” to the detailed background paper on Tab Limited. This agreement was publicly endorsed by AHA to its membership. A copy of a circular published by AHA to its members in April 2001 is attached as Annexure “TAB J” to the detailed background paper on Tab Limited.

### **(c) PubTAB commissions**

PubTAB operators receive a commission based on turnover. Commission structure and rates are identical for all PubTAB and ClubTAB outlets.

Prior to privatisation, commission was paid to PubTAB and ClubTAB outlets at a rate of 2% of turnover, regardless of the level of turnover. Commission rates have been revised on three occasions since privatisation, and in each case Tab Limited has consulted with AHA. In summary, the changes were as follows:

- In the year ended 30 June 2001, there were a number of PubTAB outlets achieving turnover of less than \$7,500 per week. It was not economic for Tab Limited to retain these low turnover outlets on the basis of the then existing commission structure. Rather than close these outlets, the commission structure was revised to pay no commission for PubTAB and ClubTAB outlets averaging turnover of less than \$7,500 per week.
- Commission rates were changed in the new standard form of agreement. This commission structure is set out in the standard form agreement. Under this new structure, totalizator turnover attracted commission of 1.125% where average turnover was less than \$7,500 per week and 2.125% where average turnover was more than \$7,500 per week. Of the 0.125% increase in commission rates:
  - 0.05% was expressly provided to offset the costs of consumables for the Daily Form Service which hotels and clubs are responsible for under the new agreement.
  - 0.05% was expressly provided to offset an increase in fees for the Sky Channel commercial service. It was expressly stated that this

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<sup>4</sup> Tab Limited has consulted with AHA and other industry bodies such as ClubsNSW (an association body for NSW registered clubs) and the TAB Agents’ Association of NSW. While these consultation processes provide useful discourse, it is essential that Tab Limited retain its flexibility in relation its distribution network. Any consultation therefore, must be a voluntary process with Tab Limited retaining its freedom, having heard the views of the industry body, to make its own commercial assessment as to the terms on which it deals with its agent, PubTAB and ClubTAB outlets (as the case may be).

<sup>5</sup> This acknowledgment is recorded in a letter from Brian Ross, Chief Executive of AHA, to Tab Limited dated 14 March 2001. A copy of that letter is contained in Annexure “TAB I”.

0.05% would be deducted if there was a reduction in Sky Channel fees.

- The remaining 0.025% was not expressly attributed.<sup>6</sup>
- Following a reduction in Sky Channel fees in May 2002, Tab Limited reduced commission rates for PubTABs and ClubTABs by 0.05% with effect from 1 July 2002 consistent with the basis on which the commission was revised with the introduction of the new standard form agreement.

In addition to commissions, Tab Limited also provides a number of benefits which are not required under the agreement with PubTAB and ClubTAB operators. These benefits, including incentive schemes, are made available by Tab Limited on a non-discriminatory basis.

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<sup>6</sup> This allocation and expression of the basis on which Tab Limited proposed to increase commissions is recorded in a letter from the managing director of Tab Limited to Mr Brian Ross, Chief Executive of AHA, dated 26 March 2001 and followed by a letter from the managing director of Tab Limited to Mr John Thorpe, President of AHA, dated 4 April 2001. Copies of these letters are contained in Annexure "TAB I".

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## 4 SKY Channel Pty Limited

### 4.1 Introduction to SKY

SKY is a satellite television broadcaster that telecasts race meetings and other sporting events throughout Australia and internationally.

SKY is the longest-standing participant in the Australian subscription television industry. SKY commenced operations in 1986, and has broadcast continuously to commercial premises (primarily hotels, clubs and TAB commercial agencies) since that date.

SKY has extensive rights to broadcast Australian thoroughbred, harness, and greyhound racing. In many cases, depending on the individual racing club involved, SKY has the exclusive rights necessary to support its core business (that is, the transmission of racing coverage to commercial premises and, via pay TV services, to residential premises). SKY also has rights to export Australian racing broadcasts to international audiences.

SKY offers its racing coverage as an entertainment service to hotels and clubs whose patrons are interested in racing. In most cases, but not all, SKY's commercial customers also offer wagering services as an additional form of entertainment for patrons. SKY's competitors in offering subscription television entertainment to hotels and clubs include FOX Sports, Austar, and various resellers of international satellite channels, including sports channels such as ESPN.<sup>7</sup>

SKY's coverage provides great benefits to participants in the Australian racing industry, generates increasing value for the industry and contributes significantly to the public profile of Australian racing. SKY consults with the racing industry to assist in structuring race meetings and race times to avoid clashes whilst ensuring maximum entertainment for viewers. SKY now covers more than 100 race meetings per week from around Australia, and broadcasts approximately 54,000 individual races each year. Almost 100% of SKY's content is Australian, and the vast majority of it consists of live sport. These factors make SKY unique in the Australian television industry.

In 1998 SKY entered the residential pay TV market as a channel supplier to the pay TV carriers, including Austar, Foxtel, and Optus. Accordingly, SKY currently creates and distributes two separate services: the "SKY Channel" commercial service, which SKY broadcasts to hotels, clubs and TAB outlets; and the "SKY Racing" domestic service, which is provided by SKY to the pay TV carriers and supplied by them to residential subscribers.

### 4.2 SKY's history

SKY was originally owned by the Bond Corporation Group of companies (**Bond**), which also owned Swan Breweries Limited. The rationale for commencing SKY and introducing live sporting entertainment via satellite into hotels was that the Bond companies had substantial ownership interests in the hotel market, and felt

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<sup>7</sup> See the detailed background paper on SKY for further information on SKY's competitive position.

that the provision of improved television entertainment tailored for the hotel market would increase liquor sales.

At the same time as SKY entered the market, the NSW Club industry commenced a satellite TV station called Club Superstation, financed by Robert Holmes a Court. The clubs saw a threat to their traditional market posed by SKY, should it be successful in obtaining exclusive special events for Bond hotels. Club SuperStation operated using a substantially similar pricing formula to SKY (at the time). In 1987 Club SuperStation was purchased by SKY. SKY was purchased by TAB on 15 April 1998.

### **4.3 SKY's contract structure**

SKY uses standard form contracts for hotels and clubs. The same standard form contract applies nationally. The current standard form contract has been used for many years and has not changed since SKY was acquired by Tab Limited in April 1998.

The standard form contract provides for a nominal five year term, although hotels and clubs may terminate at any time within that five year term on six months' notice. SKY's standard form contract and rate card are attached as annexure "SKY A" to the detailed background on SKY.

### **4.4 Pricing of the SKY Channel service to hotels and clubs**

#### **(a) Overview of SKY's pricing model**

The Sky Channel service is part of the entertainment offered by hotels and clubs to their patrons. SKY believes that this assists in attracting and retaining customers and that this increased patronage assists the hotel or club through increased sales of other products (such as food and beverages). In addition, for hotels or clubs with wagering facilities such as PubTABs and ClubTABs, the availability of racing coverage through the Sky Channel service assists in enhancing wagering turnover.

SKY's pricing formula is intended to:

- reflect these benefits which hotels and clubs derive from the Sky Channel service; and
- provide a tiered pricing structure which makes allowance for the extent of the benefits derived and the size of the venue. This tiered pricing structure was adopted in the early 1990s in response to submissions from the Australian Hotels Associations in the various States and other industry groups urging SKY to adopt a tiered pricing structure which recognised differences in the sizes of their various members' establishments as this was then asserted to be a fairer system, particularly for smaller hotels.

SKY charges hotels and clubs for the Sky Channel service on the basis of a standard rate card which is publicly available. The same rate card is applied nationally, except in Western Australia where a discount of 25% is applied in recognition of the impact of time zone differences on the value derived by Western Australian hotels and clubs from the service.

Under SKY's rate card, the fees for the Sky Channel service are determined by reference to the Annual Bulk Beer Literage and, for those outlets with PubTAB or

ClubTAB facilities, wagering turnover. Different scales apply depending on whether or not the hotel or club has wagering facilities.

The standard form contract provides for prices to be adjusted during the term (up or down) if a hotel changes its trading pattern (ie. greater or lesser bulk beer sales and wagering turnover). In practice, the fees are generally fixed at the start of the contract and do not adjust during the contract term other than for CPI adjustments. SKY does not actively seek from hotels and clubs details of their bulk beer sales and wagering turnover. That information is generally provided only when a contract is being entered into or renewed. Therefore, SKY is generally unaware of any changes unless a hotel or club approaches SKY and claims a reduction in price based on reduced beer sales and wagering turnover. Accordingly, prices are rarely increased (and far more often decreased) during the five year term.

**(b) Evolution of SKY's pricing model**

In 1986, as a Bond company, the price of SKY subscription was related to beer sales. Initial subscription agreements ran for a term of five years, with amounts payable in arrears. The price for subscription to SKY services was set as a flat quarterly fee of \$1625, with a licence agreement similar to the current agreement. Subscribers could obtain a quarterly 10% rebate off their SKY subscription fee per litre of beer purchased above the previous quarter's total beer sales. Most sites received the maximum rebate of \$1600 under this scheme.

Licence Agreements signed from 1990-91 were payable in advance rather than in arrears (as had previously been the case), with annual price assessments and increases occurring on the first of July every year.

In the late eighties and early nineties SKY was lobbied by the Australian Hotels Associations of the various States and other industry groups to restructure its pricing for the Sky Channel service into a tiered system. These branches of the Australian Hotels Association and other industry groups asserted that because of the differences in the sizes of their various members' establishments, a tiered pricing formula was a fairer system, particularly for smaller hotels.

In response to these submissions, SKY, in conjunction with the AHA, constructed the pricing formula using the "Annual Liquor Licence" fee levied by State Governments. These liquor licence fees were based on total liquor sales of the relevant hotel or club. This pricing structure was developed in conjunction with the AHA and the Registered Clubs of NSW (now known as Clubs NSW), through a process which also involved significant consultation with other industry bodies including the Queensland, Victorian, South Australian and Western Australian branches of the Australian Hotels Association. During this process, and following representations by the Western Australian branch of the Australian Hotels Association, SKY recognised the impact of time zone differences on the benefits which Western Australian hotels and clubs derived from Sky Channel programming by providing Western Australian hotels and clubs with a discount from the standard pricing for the service.

Most, but not all, hotels acquiring the Sky Channel service have wagering facilities.<sup>8</sup> In recognition of this, and the fact that subscribers with PubTAB or

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<sup>8</sup> While numbers vary, the percentage of hotels and clubs who subscribe for the SKY Channel service and who have a PubTAB or ClubTAB facility is generally in the order of 90%.

ClubTAB facilities also benefit from the impact of the Sky Channel service in enhancing wagering turnover, in 1995 SKY divided its standard rate card into two parts:

- one which applied for hotels and clubs with PubTAB or ClubTAB facilities; and
- the other for hotels and clubs without PubTABs or ClubTABs.

In 1998, as a result of a decision of the High Court of Australia in relation to excise duty, the basis on which liquor licence fees had been levied by State Governments became illegal. This removed one of the elements on which SKY at that time determined its pricing, forcing SKY to find an alternative measure. SKY considered that annual bulk beer litres was the closest proxy to the basis on which liquor licence fees had previously been charged. This change took effect in May 1998.

There has been no change to the structure of SKY's pricing model for the Sky Channel service to hotels or clubs since SKY was acquired by Tab Limited in April 1998 other than changing the component of the fee previously based on liquor licence fees to annual bulk beer litres, which change was a necessary consequence of the High Court's decision and was consistent with the underlying principle on which the pricing model was based. While that change was determined prior to Tab Limited's purchase of SKY, it did not take effect until immediately after the purchase was completed (but before Tab Limited was privatised).

SKY has conducted market research to investigate whether linking prices to beer sales was appropriate. The results of the market research showed that a significant number of hotel customers cited the availability of SKY as the main reason why they frequented the particular hotel, supporting SKY's view that the Sky Channel service assists in attracting and retaining patrons.

### (c) Changes in pricing for the SKY Channel service

Since Tab Limited acquired Sky, the rate of price increases charged by SKY to hotels and clubs for its Sky Channel service has reduced significantly compared to those which were applied before Tab Limited's acquisition of SKY. The following table illustrates the rate of increase in the applicable rate card for the Sky Channel service since 1995.

Year	Pricing change in Rate Card	Annual CPI for June quarter
1995	Fees increased by 5.0%	4.5%
1996	Fees increased by 4.0% (expanded price list)	3.1%
1997	Fees increased by 8.0%	0.3%
1998	Fees increased by 5.0%  This increase was being developed by SKY prior to Tab Limited's acquisition of SKY. Following Tab Limited's acquisition of SKY, SKY announced the removal of the top layers from its rate card, providing an effective price reduction for large customers.	0.7%
1999	No fee increase - 12 month price freeze	1.1%



2000	Fees reduced by 0.25% as SKY passed on benefits from cost savings resulting from the introduction of GST	3.2%
2001	Fees increased by 3.0%	6.0%
2002	Fees reduced by 5.0%	2.8%

On 19 July 1999, SKY announced a price freeze for a period of twelve months effective immediately, and applicable to all hotels and clubs.

In 2000, following the introduction of the goods and services tax (GST), SKY announced that savings generated in its operations by the new system tax changes allowed a 0.25% reduction in subscription fees payable. This was effective immediately.

On 16 May 2001, SKY announced a 3% subscription fee increase.

On 1 September 2001, following consultation with the West Australian branch of the Australian Hotels Association, SKY announced that the rebate on its standard price list provided to its Western Australian customers on account of the impact of time zones would be 25%.

Since the mid-1990s, the high and increasing fees paid by SKY to racing clubs for broadcast rights have been a major factor in influencing SKY's pricing of the Sky Channel service. The Managing Director of Tab Limited and SKY, Mr Warren Wilson, announced in 2001 that, if SKY was able to reduce rights fees, it would also seek to reduce its retail price to hotels and clubs.

SKY's agreement for the broadcast rights to Victorian thoroughbred racing had been – and continues to be – one of SKY's most expensive rights contracts. That agreement was renegotiated in April 2002. As part of the renegotiation SKY was able to achieve a reduction in the level of fees paid for the right to broadcast Victorian thoroughbred racing. A press release dated 22 May 2002 issued by Racing Victoria Limited in connection with the new agreement for broadcasting of Victorian thoroughbred racing is attached as Annexure "SKY B" to the detailed background paper on SKY.

Consistent with Mr Wilson's announcement, SKY announced a reduction of 5% in its prevailing subscription fees applicable to hotels and clubs effective 1 July 2002. SKY also announced that it would forego a planned CPI increase of 2.8%, providing a net benefit to customers of almost 8%. No increase in price (even for CPI increases) is planned for 2003, with no change in trading terms to be contemplated until 1 July 2004.

Given the pattern of five year terms, approximately 20% of SKY's hotel and club subscriber base is due for contract renewal each year. At the time of contract renewal, the fees are re-assessed having regard to the customer's annual bulk beer literage and wagering turnover in the year preceding the renewal. As a result of increases in rate card and changes in their trading position over the preceding five years, many customers face significant price increases on renewal of their subscription.

To address this issue, SKY also announced that effective 1 July 2002, when subscription contracts are renewed, the increase in each of the first two years of the term of the new contract will not be more than 15% p.a.

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## 5 The conduct

### 5.1 Particulars of conduct

In the Commission's letter of 4 September 2002 to Spier Consulting, the Commission set out its understanding of the proposed conduct in the following terms:

1 *Collective Bargaining*

*The AHA NSW seeks authorisation to conduct collective contract negotiations on behalf of any group of AHA NSW members (a collective bargaining group) with TAB Limited and SKY Channel in relation to the provision of wagering and/or racing broadcast services. Such contractual negotiations will potentially encompass all aspects of the supply arrangements, including price.*

2 *Primary Boycott*

*The AHA NSW seeks authorisation for a collective bargaining group represented by the AHA NSW to collectively withdraw services to TAB Limited and Sky Channel, should contractual negotiations break down and not recommence within 7 days.*

*In respect of both applications, the Commission understands the following matters to apply.*

*The application (as clarified in the meeting of 31 July meeting) names and refers to present and future AHA NSW members as parties or proposed parties to the proposed arrangements.*

*Pursuant to subsection 88(13) of the Act, the authorisation application applies to any collective bargaining group of AHA NSW members, present or future, represented by the AHA NSW that wishes to engage in the proposed conduct.*

*AHA NSW member participation in both collective negotiations and primary boycott activity is voluntary. AHA NSW members retain the right to negotiate and enter into individual contracts with TAB Limited.*

*The Commission understands that more than one collective bargaining group may form pursuant to the applications for authorisation. However, the Commission understands that the exact composition of each potential collective bargaining group is not presently known to the AHA NSW. In these circumstances, pursuant to subsection 88(14) of the Act, if an authorisation is granted in respect of the proposed arrangements where the names of the future parties are not known at the time the application is made, any authorisation will be deemed to be subject to the condition that the AHA NSW will, upon request by the Commission, provide the names of all members who are parties to any contract.*

In its letter to the Commission of 13 September 2002, Spier Consulting confirmed that Commission's understanding of the features of the Application was correct.

Tab Limited and SKY proceed on the basis that the matter quoted above is a full and accurate description of the conduct for which authorisation is applied.

## 5.2 The need for certainty

There is considerable uncertainty regarding the conduct for which authorisation is applied. Tab Limited and SKY have previously drawn this to the Commission's attention in letters from their solicitors, Freehills. The Commission has attempted, in meetings and correspondence with AHA, to construct the terms of an "arrangement" of sufficient certainty to enable the Commission to discharge its functions under the Act. However, considerable uncertainty remains.

Section 45, by virtue of sections 45A and 4D, proscribes making a "contract, arrangement or understanding" containing provisions that have a certain character, and also proscribes giving effect to such provisions. Given the width of the phrase "contract, arrangement or understanding", there often is little doubt in identifying conduct that would breach section 45 by virtue of either section 45A or section 4D, even where the relevant contract, arrangement or understanding is not a formal legal instrument or has not been reduced to writing in any form. In the case of AHA and its member hotels and their proposed conduct, there is little doubt the conduct would breach section 45 absent authorisation.

However, while the likelihood of a breach of section 45 is clear, meeting the tests for authorisation requires much greater certainty as to the terms of the relevant contract, arrangement or understanding. The Commission may not grant authorisation unless it is satisfied that "the provision of the proposed contract, arrangement or understanding" (s.90(6)) or "the proposed provision" (s.90(8)) ... "would result, or would be likely to result" (s.90(6) and (8)) in a benefit to the public etc.

In other words, while the likelihood of a breach of section 45 absent authorisation is clear even though the contract, arrangement or understanding is uncertain and the provisions to which sections 45A and 4D apply have not been clearly articulated, when it comes to determining whether to grant authorisation the Commission must require far greater certainty and clarity.

There are a number of critical areas of uncertainty in connection with the Application.

## 5.3 Target contracts

First, it should be noted that the underlying commercial relationships and contracts between AHA member hotels and TAB Limited and SKY, which are the targets of the proposed conduct, differ in some key essentials:

- Tab Limited appoints hotels as its agents in relation to its wagering business. The hotels **supply** PubTAB agency services to Tab Limited. Tab Limited's wagering business is highly regulated, requiring a high level of control over hotels in their agency activities and justifying use of standard form contracts. Tab Limited enters into such contracts only in NSW.
- The hotels **acquire** SKY Channel services from SKY. The conduct of hotels in receiving and displaying SKY Channel does not impact on SKY in the same way their conduct impacts on Tab Limited. SKY enters into such contracts with hotels and clubs throughout Australia.

The majority of AHA member hotels have existing contracts on foot with Tab Limited or SKY, or both, terminable on one month's notice in the case of Tab Limited and six month's notice in the case of SKY. Those contracts and their pricing structures are standard and uniform, and open and transparent. The Tab Limited contract has been used since 2001 and both the form and terms of the contract, as well as the commission structure, were the subject of extensive consultation between Tab Limited and AHA. The SKY contract has been in use for over 10 years and predates Tab Limited's acquisition of SKY.

If authorised on the basis proposed by AHA, the conduct must necessarily contemplate interference with those existing contracts. The Application gives no particulars of terms of either contract that AHA seeks to have amended, other than the period of notice of termination under the SKY Channel contract and, perhaps, the wagering turnover and literage information required to calculate fees under the SKY Channel contract. There is no evidence that, or reason in principle why, either term should be regarded as harsh, unfair or unreasonable or should be altered.

It is plain that the sole objective of AHA is to attempt, by collective negotiations and the threat of primary boycotts, to secure increases in Tab Limited's commissions and decreases in SKY's fees.

#### **5.4 Hotels participating**

AHA member hotels are not a homogenous group:

- some members own a single hotel, others own a group or chain of 20 or more hotels extending across a number of States;
- some hotels are in country towns, many are in metropolitan areas, and as a result different hotels face varying degrees of competition from other hotels;
- some hotels are effectively sole traders, other hotels are in reality very large corporations, whether privately controlled or, in the case of ALH, a division of one of Australia's largest, vertically integrated, listed public companies (Fosters Group Limited);
- some hotels are more traditional hotels with only a handful of gaming machines, others are large complexes with 20 or more gaming machines;
- some hotels will be "marginal", others will be "infra-marginal", in the sense of their performance under Tab Limited's rate of return requirement and their efficiency as a wagering services distribution outlet (see the NECG report).

It is not clear whether the collective bargaining groups envisaged by the Commission would consist of similar or diverse hotels. AHA's proposed conduct is likely to have different outcomes and effects depending on the membership of a collective bargaining group. It is likely that a collective bargaining group or groups would consist mainly of, or be dominated by, the large groups or chains of hotels and the infra-marginal hotels.

There is no analysis in the Application of the effects the conduct would have on the diverse types of hotels that constitute AHA's members.

## 5.5 Hotel industry

The hotel industry is not facing a period of deregulation, restructuring, or transition. It is true that the advent of gaming machines has had a dramatic impact, and that gaming machines drive a lot of strategic and competitive behaviour in the industry. However, PubTAB agencies and SKY Channel services are established, albeit minor and ancillary, parts of the hotel industry landscape.

Tab Limited commissions are a minor and ancillary component of total hotel income, but nonetheless represent high margin incremental income. The base capital costs incurred by a hotel are relatively minor, and any incremental capital is entirely in the hotel's control. The incremental operating costs are nominal.

SKY Channel fees are a minor and ancillary part of hotel overheads, but contribute to total hotel turnover. SKY estimates that, if the literage component of its fees were allocated solely to hotel beer sales, it would represent only about 2% of the typical price of a 250 ml middy in NSW. However, SKY Channel in fact contributes to total hotel turnover, not just bulk beer sales.<sup>9</sup>

AHA has made generalised claims about “unconscionability”, “industry harmony” and “equity”. However, in the period before AHA advised Tab Limited and SKY that it intended to seek authorisation – the relevant period for testing those claims – neither Tab Limited nor SKY was aware of any widespread or general dissatisfaction, complaints, or disharmony from NSW hotels concerning:

- the form or terms of their contracts;
- the structure or level of commissions or fees; or
- the process of entry into or renewal of contracts.

## 5.6 Racing and wagering industries

There is no analysis of the effect the conduct would have on the output decisions of Tab Limited and SKY. Tab Limited itself cannot pass on any increase in commissions paid to hotels. An increase in Tab Limited commissions would make many smaller hotels uneconomic as distribution outlets for Tab Limited and likely result in Tab Limited ceasing to acquire agency services from them. This would lead to a reduction in the output of wagering services and the use of less efficient channels of distribution.

A decrease in SKY fees would likely have spill-over effects extending beyond New South Wales, because SKY uses uniform pricing for all commercial premises Australia wide. A reduction in fees would lead to lower output from SKY in terms of fewer races being covered and ultimately lower output from the racing and wagering industries.

## 5.7 Conclusion

The position remains entirely uncertain, despite the Commission's efforts to elucidate from AHA details of the contract, arrangement or understanding among AHA member hotels and of any relevant collective bargaining group, and more importantly details of the relevant provisions of the contract, arrangement or

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<sup>9</sup> Where hotel also has a PubTAB facility, the cost of SKY Channel is offset by PubTAB commissions.

understanding that will result in benefits to the public sufficient to justify the grant of authorisation.

The Commission has no way of knowing the composition of a collective bargaining group drawn from the diverse members of AHA, still less the effect the proposed conduct would have on the ability or incentives of any such group to bring about more efficient outcomes in any of the industries affected, especially when compared with the situation that obtains today.

It is the situation which obtains today which provides the relevant counterfactual for the purposes of the Commission's analysis and the application of the "future with and without the proposed conduct" test for authorisation.

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## 6 AHA's arguments

### 6.1 An overview of AHA's arguments

AHA claims in the Application and associated submissions and supporting material that the conduct to be authorised will result in a number of public benefits, and that these benefits outweigh any possible public detriment resulting from the conduct.

A list of public benefits claimed is provided on page 6 of the Application. However, this list is not uniformly matched by the benefits discussed later in the Application and in subsequent correspondence.

In summary, the public benefits claimed in the list on page 6 of the Application are:

*Ensuring the continued viability of small business operations, particularly in rural and regional areas, thus ensuring competition in those areas*

*Assistance to the efficacy and competitiveness of small business by:*

- *Facilitating the availability of information on operational and pricing issues*
- *Limiting transaction costs in negotiation of supply agreements*
- *Freeing up small business operators to focus on increasing the competitiveness of their business*
- *Fostering industry harmony*
- *Promotion of equitable dealings in the market*

*Providing countervailing/bargaining power to small business in dealing with large and powerful suppliers*

*Promotion of industry cost savings, potentially resulting in contained or lower prices at all levels in the supply chain*

*Supply of better information to suppliers to permit more informed choices in their dealings with small business*

*Equity in the market.*

Other public benefits cited in the Application and other correspondence are:

*Collective negotiation of a common system and increased business efficiencies (page 7 Application).*

*Promotion of equitable dealings in the market - countervailing power (page 8 Application)*

*Small business efficiency/ viability (page 9 Application)*

*Supplier efficiency (page 10 Application)*

*Equity (page 11 Application)*

*Allowing presently uneconomic sites to operate because they would be able to better afford the cost of SKY Channel (page 4 attachment 6, letter from Spier to ACCC dated 13/09/2002).*

*Build confidence in the product (page 4 attachment 6, letter from Spier to ACCC dated 13/09/2002).*

*Allow more hoteliers to support the NSW racing industry (page 4 attachment 6, letter from Spier to ACCC dated 13/09/2002).*

*Greater protection for the public in the arena of responsible gambling (page 4 attachment 6, letter from Spier to ACCC dated 13/09/2002).*

These public benefits claimed by AHA are quoted and referenced in the order in which they were presented by AHA, and each individually addressed by Tab Limited and SKY, in the remainder of this section.

## **6.2 Public benefits claimed on page 6 of the Application**

### **(a) Ensuring the continued viability of small business operations, particularly in rural and regional areas, thus ensuring competition in those areas**

AHA provides little evidence to support the claim that collective negotiations will ensure the continued viability of small business operations, particularly in rural and regional areas, thus ensuring competition in those areas.

This claim must rest, if at all, on expected increases in PubTAB commissions and decreases in SKY Channel fees and reduced transaction costs. However, as noted elsewhere in this submission:

- PubTAB commissions are a minor and ancillary part of hotel turnover;
- an increase in PubTAB commissions is likely to result in fewer hotels supplying PubTAB agency services to Tab Limited or marginal hotels supplying PubTAB agency services on less advantageous terms than at present;
- SKY Channel fees are a minor and ancillary part of hotel overheads;
- SKY Channel fees, being based on TAB turnover and beer literage, are minimal at the margin and hence help promote the viability of hotels; and
- if authorised the conduct is likely to result in increased transaction costs for hotels as well as for Tab Limited and SKY.

There is no evidence provided that the viability of hotels, generally or in rural and regional areas, is under threat, still less that possible gains from collective negotiations with Tab Limited and SKY would have any impact on that viability. To address any cases of genuine hardship, SKY offers a remote site tariff (price reductions) for truly isolated hotels in small rural communities.

In so far as the claim focuses on rural and regional areas, Tab Limited notes the recent practice of city hotels purchasing rural and regional hotels in order to obtain the gaming machine entitlements, in order to transfer the gaming machines to city hotels. Following the transfer of gaming machine entitlements, it is expected that many of these rural and regional hotels will be closed.



**(b) Assistance to the efficacy and competitiveness of small business**

**(1) *Facilitating the availability of information on operational and pricing issues***

In a letter to the Commission dated 5 September 2002, AHA asserts that Tab Limited contracts are secretive and that collective negotiations will allow greater disclosure and transparency, which will be of particular benefit to small businesses, who currently do not know how their Tab Limited and SKY charges compare with other like establishments.

However, details of the standard Tab Limited and SKY contracts and pricing structures are publicly available.

In addition Tab Limited and SKY each independently consult with AHA on a variety of issues, including changes to contracts and pricing, before they are introduced. AHA can disseminate this information to its members currently without the need for collective negotiations.

AHA submits that it requires authorisation in order to allow it to circulate market information among hotels, organise external legal advice, pool data, and provide other support to hotels in their dealings with Tab Limited and SKY. Tab Limited and SKY submit that none of this behaviour is likely, of itself, to constitute a breach of the *Trade Practices Act 1974*. Many other industry bodies, across an array of industries, provide these services to members without requiring authorisation for the kinds of anti-competitive conduct required by AHA.

AHA has not provided details about how authorisation would improve information sharing and transparency, or why the amount or quality of information that it currently holds would improve, as a result of authorisation of the proposed conduct. In the absence of such proof the Commission cannot treat this as a relevant public benefit.

Even if there were scope for improved information sharing and transparency, it would not require collective negotiations, and especially not price fixing and primary boycotts, to obtain and disseminate the improved information. There is no causal connection between the conduct requiring authorisation and the benefit claimed.

**(2) *Limiting transaction costs in negotiation of supply agreements***

AHA claim that by negotiating with Tab Limited and SKY, transaction costs will be lowered, on the basis that this is more efficient than the current individual negotiation system. This claim, however, is inconsistent with another assertion by AHA that Tab Limited and SKY refuse to negotiate individually and use standard form contracts.

Transaction costs are currently minimised as a result of the use of standard form contracts by Tab Limited and SKY. These contracts and the pricing structures were developed and adopted by Tab Limited and SKY following consultation with AHA.

Collective negotiations by AHA will not reduce transaction costs for Tab Limited or SKY, particularly given the proposal that member hotels can opt in/opt out of any deal negotiated by AHA. Tab Limited and SKY each may need to use at least two (and more likely several) contracts (one for each collective bargaining group and the other for non-participants), rather than one standard contract. This will

result in an increase to net transaction costs, rather than a decrease as AHA claims.

Even if there were scope to reduce transaction costs further (which Tab Limited and SKY deny), price fixing and primary boycotts would not be the means by which these reductions were obtained. By their very nature, conduct of this severity would necessarily create tensions and disharmony and increase transaction costs for all parties.

(3) ***Freeing up small business operators to focus on increasing the competitiveness of their businesses***

AHA does not proffer any evidence in support of this claimed benefit. Tab Limited and SKY assert that collective negotiations will not benefit small business operators with any greater amount of time in which to focus upon increasing the competitiveness of their businesses than is available as a result of the current standard form contract process. Indeed, if transaction costs increase, the opposite is likely to be the case.

(4) ***Fostering industry harmony***

AHA does not proffer any evidence in support of this claimed public benefit, nor explain how such a benefit could be attained solely as a result of authorisation of price fixing and primary boycotts. By its very nature, this conduct would more likely destroy industry harmony.

(5) ***Promoting equitable dealings in the market***

For a discussion of this claim, see 6.2(f) below.

(c) **Providing countervailing/bargaining power to small business in dealing with large and powerful suppliers**

AHA claims that authorisation will provide countervailing power to small business in dealing with “large and powerful suppliers”. As noted elsewhere in this submission, many members of AHA are large and complex businesses and the collective bargaining groups that would emerge under authorisation would likely be dominated by these members.

In the Dairy Farmer’s application (A90782) the Commission stated at paragraph 8.107:

*“The Commission does not accept that a mere change in the amount of countervailing power is, in itself, necessarily a public benefit. Rather the Commission will focus on the likely outcomes resulting from the proposed arrangements for which authorisation is sought. It is these likely outcomes that are essential to the net benefits test. Generally the Commission would accept an argument about countervailing power as a public benefit where it is satisfied that enhancing the bargaining power would benefit the broader community, for example, if a likely result of increasing a party’s bargaining power was the lowering of prices for consumers.”*

AHA has provided no evidence of any likely outcomes which would benefit any party other than the benefits likely to be enjoyed by AHA member hotels.

**(d) Promotion of industry cost savings potentially resulting in contained or lower prices at all levels in the supply chain**

AHA asserts that authorisation will promote industry cost savings potentially resulting in contained or lower prices at all levels in the supply chain. SKY Channel fees are only one minor component of hotel overhead costs, and PubTAB commissions are only a small component of hotel revenue. Given these facts, it is difficult to see how collective negotiations could promote industry cost savings of any significance, or result in contained or lower prices at all levels in the supply chain.

Any possible gains from price fixing or collective boycotts will have no impact on direct or variable costs of hotel output, and would have insignificant impacts on total hotel turnover and overheads. There is no basis for expecting any pass through of gains to hotels in lower prices or improved service to hotel patrons. In fact, as noted in NECG's report, history shows that when the "A New Tax System" changes occurred, hotels failed to pass on net reductions despite more direct impacts and the sanctions of penalties. In the present case there is even less likelihood of any pass on.

Further, as noted elsewhere, the conduct proposed would likely increase the cost of waging services by forcing Tab Limited to use less efficient distribution channels.

**(e) Supply of better information to suppliers to permit more informed choices in their dealings with small business**

AHA has submitted that conducting the negotiations jointly will enable AHA member hotels to gain access to information, including general market information regarding income trends and operating expenditures, which members would ordinarily not be in the position to obtain. AHA claims that having access to such information will assist AHA member hotels, in particular small businesses, in making more informed and better business decisions and in better assessing their long term survival.

It is claimed that AHA member hotels will also obtain the benefits of jointly obtaining financial, accounting and legal advice, should the Application be authorised, and that obtaining this information will:

- enable more efficient negotiations to be conducted which are likely to lead to a more efficient outcome;
- result in lower transaction costs for individual AHA members hotels; and
- potentially result in lower costs to end consumers.

AHA does not require an authorisation to provide the types of information and services that it can currently provide as an industry association. For further discussion see point 6.2(b) above.

**(f) Equity in the market**

The difficulties which AHA has claimed exist for hotels, such as size, onerous terms, and standard form contracts, are no different to the difficulties experienced by small businesses and customers in many markets including, for example, banking, commercial leasing and household pay-TV subscription.

AHA has not provided any evidence of conduct by Tab Limited or SKY that has lead to any investigation by the Commission or court proceedings based upon unconscionability. The claim that Tab Limited and SKY have acted unconscionably is unfounded. Even if there were any unconscionable conduct, it would be able to be dealt with in the normal course and in accordance with the Act and, in relevant circumstances, with the assistance of the Commission.

### 6.3 Other public benefits claimed in the Application

#### (a) Collective negotiation of a common system

At page 7 of the Application, AHA states:

*It is the general practice of TAB/SKY CHANNEL to adopt standard contracts across the industry in NSW and to some extent similar contracts in other jurisdictions. However the NSW contract is more onerous and less flexible than elsewhere. The approach adopted by TAB/SKY CHANNEL clearly demonstrates two points:*

- *That there are increased business efficiencies arising from a consistent approach; and*
- *That SKY /CHANNEL is not disposed to negotiate individually with a large number of small businesses.*

*It is inequitable for a small business in the position of AHA members to be faced with circumstances where only one party to the transaction can negotiate on a wider basis. In fact in relation to some TAB/SKY CHANNEL products, it insists on dealing with the AHA (NSW) on a 'one in or all out' basis."*

It is unclear from the Application whether or not AHA favours collective negotiation in a common system or not, given contradictory statements favouring "individual contracts" on one hand, and a "common system" on the other.

In relation to the Tab Limited contract, Tab Limited's business is highly regulated and Tab Limited is liable for the activities of its agents (including PubTAB operators' conduct of Tab Limited's wagering business). The most efficient way of monitoring and maintaining standards in the conduct of its wagering business is for Tab Limited to use standard form contracts.

Contrary to AHA's assertion, Tab Limited contracts cannot be more onerous in NSW than in any other State, as they are available only in NSW. Nowhere in the Application is it suggested that differences in the terms and conditions in the Tab Limited contracts between hotels is warranted on any ground other than price.

In relation to the SKY contracts, given the number of customers that SKY services, standard form contracts are the only efficient way for SKY to contract. SKY uses standard contracts Australia wide (save for very minor differences in price, as outlined in Part 4 above). Nowhere in the Application is it suggested that differences in the terms and conditions in the SKY contracts are warranted on any ground other than price.

Neither Tab Limited or SKY accepts the allegation that they have dealt with AHA on a 'one in all in' basis. Tab Limited and SKY do not insist on collective bargaining with AHA. Each has, however, consulted with the AHA on a variety

of issues including proposed changes and, on some occasions, may have decided not to proceed with a proposal on advice of AHA.

**(b) Promotion of equitable dealings in the market - countervailing power**

At page 8 of the Application, AHA states:

*Commercially AHA members have no choice but to continue to take TAB/SKY CHANNEL services largely in order to attract customers who will also purchase other hotel products such as food or beverages.*

*.....It is the practice of TAB/SKY CHANNEL to present standard form contracts to all members.....*

*Permitting collective negotiation has the public benefit of providing countervailing bargaining power to small business in negotiation with an unusually powerful supplier. This power is highlighted by the information that TAB/SKY CHANNEL demands from AHA members, information having little to do with the wagering or broadcasting business such as total litreage sales and related commercial information.....*

*The ability to negotiate collectively with TAB/SKY CHANNEL will not have an anti competitive effect by putting AHA members in an advantageous position, but will simply 'level the playing field'. If the Commission thought that there was an anticompetitive effect, we submit that it is more than outweighed by the public benefits....*

For further discussion in relation to the claims relating to standard form contracts see 6.2(b)(2) above.

As discussed above at 6.2(b)(1), AHA does not give any examples of unreasonable terms, except in regard to demands for information that are required as part of SKY's pricing formula (such as wagering turnover and literage).

Neither Tab Limited nor SKY acquire services from hotels or supply services to hotels that are of an essential character to hotels' livelihoods.

For a further discussion of SKY pricing see 6.4 below.

**(c) Small business efficiency/viability**

At page 8-9 of the Application, AHA states:

*Facilitating the conduct of joint negotiations on TAB/SKY CHANNEL service will assist in small business efficiency by increasing the availability to members of information, including information about income trends and operating expenses, which will give them an improved understanding of the effect of wider trends upon their businesses, and improve their ability to make better business decisions.*

*To conduct negotiations individually, assuming that negotiations were realistic, members would be required to obtain financial and accounting advice to formulate the necessary submissions about income and operating expenses, and legal advice to assist in conducting negotiations. Obtaining this advice separately will lead to increased transaction costs for individual small businesses.*

*..... collective negotiation facilitates a mechanism for gathering and collating information relating to income trends and operating expenses, which would otherwise not be available.*

*In undertaking collective bargaining, the AHA (NSW) would be in a position to obtain legal advice with regard to contractual provisions, which would minimise costs to individual members. This process would assist individual members in identifying areas where efficiencies and cost savings could be obtained.*

*..... more than 50% of the AHA (NSW) membership operate in rural and regional areas, and the public benefit of promoting efficiency of small business in those areas is clear.*

Tab Limited and SKY submit that the benefits claimed do not require or justify authorisation (see further discussion at 6.2(b) above).

**(d) Supplier efficiency**

At page 10 of the Application, AHA states:

*TAB/SKY CHANNEL will also be assisted by the provision of industry wide information to provide guidance on realistic pricing. This improved supply of information will assist in increasing supplier efficiency by permitting informed decisions.*

*.....The grant of authorisation for negotiations by AHA would obviously be of assistance to SKY CHANNEL in its often expressed wish to adopt a national approach to their dealings with the industry. SKY CHANNEL operates nationally and whilst there are State differences, it seeks to adopt a national stance.*

Tab Limited and SKY currently have access to all necessary information required in setting efficient prices. This information is obtained from publicly available data and regular consultation with AHA, hotels and other industry participants. AHA has not demonstrated how authorisation could improve the quality of this information. Tab Limited and SKY are not suffering from an information asymmetry.

**(e) Equity issues**

At page 11 of the Application, AHA states:

*Public benefit is not only about economics but also fairness. The Parliament... has passed the unconscionable conduct law... We submit that the Commission must take that into account in any public benefit assessment.*

*It is contended that the Commission saw the merit in providing assistance to dairy producers, poultry growers, private hospitals, lorry owners drivers and others in granting an authorisation, the granting of one in this case is an appropriate case.....*

The Application differs significantly from other collective negotiation authorisations that have been granted - as discussed below. Tab Limited and SKY submit that to grant authorisation in respect of the Application would be wholly inconsistent with the rationale for granting other collective negotiation

authorisations such as those covering dairy farmers, chicken growers and newsagents.

#### **6.4 Public benefits claimed in the letter dated 13 September 2002**

On page 4 of attachment 6 to the letter dated 13 September 2002 from Spier Consulting to the Commission ("*A note on the detriment/ benefit considerations in relation to this application*") the following public benefits are claimed:

*The major benefit of a more open and competitive PubTAB/SKY Channel market would allow presently uneconomic sites to operate eg country and small rural hotels would be able to offer wagering to regional patrons because they would be able to better afford the cost of SKY Channel. This would assist country people to enjoy the same accessibility as residents of Sydney to wagering services and racing broadcasts.*

*Overall the open negotiation system would simply build confidence in the product. The Association would be better able to endorse the product and through collective bargaining a significant reduction in SKY Channel would allow more hoteliers to support the NSW racing industry.*

These allegations focus upon the cost of SKY Channel. Given that the existing SKY Channel fees are geared to wagering turnover and litreage, SKY assumes that the outcome that AHA seeks to achieve is either a reduction in the overall level of SKY Channel fees, or a move to a fixed rate for all establishments.

There is no evidence that SKY is earning monopoly rents. The basis of SKY's pricing is consistent with both economic theory and regulatory practice. There is no evidence that a reduction in SKY's pricing is warranted.

The SKY Channel service is characterised by substantially fixed costs, such that charging on the basis of the marginal cost of supply to individual hotels or other customers would not recover total production costs. A further characteristic of the SKY Channel service is that it is non-rivalrous in consumption, i.e. the same service can be consumed simultaneously by multiple subscribers. It is well recognised by economists and regulators that in such circumstances, pricing according to ability to pay promotes efficient levels of output and consumption. The fee reflects the value which hotels derive from the SKY Channel service.

To the extent that authorisation may increase the bargaining power of AHA member hotels and force a reduction in the quantum of SKY's fees, a mere transfer of funds from one level of the market to another does not constitute a public benefit.

AHA's claims in relation to SKY's pricing are possibly based upon the assumption that there is a more efficient price level that SKY could adopt. However, no evidence to support this assumption is proffered to the Commission or has previously been provided to SKY. Using the value derived from SKY's product is the most efficient way to set prices.

A transition to a fixed price would likely lower the cost of SKY Channel to large hotels and increase the cost of SKY Channel to small hotels. Further, a reduction in the price of SKY Channel may render SKY unviable if it is forced to price below average cost, which in turn would harm the racing industry, a major employer in regional Australia, through lowering rights fees.

AHA also claims on page 4 of attachment 6 to the letter dated 13 September 2002 to the Commission that:

*A further public benefit that would arise from the Australian Hotels Association's (NSW) campaign is greater protection for the public in the arena of responsible gambling. Presently the NSW Government has introduced the Responsible Gambling Program. Hoteliers and their key staff undertake this (Responsible Gambling Conduct Course) as part of their allowance to operate poker machines. The Association would like to extend this management to cover the operation of all PubTABs in this State. However, at present because of the secretive nature of the TAB contracts which cover operator rules, operator conduct and general behaviour there is presently not even an open arena in which the Association can ensure responsible wagering to the public.*

AHA has not offered any evidence in support of these claims, or provided any arguments as to how responsible gambling could be addressed only through the authorisation of the conduct. Tab Limited and SKY dispute that their contracts are 'secretive' particularly as they use standard contracts that are readily available. Further, Tab Limited submits that the issue of responsible gambling is addressed and can be further addressed effectively in the absence of authorisation, and that authorisation will not further the cause of responsible gambling whatsoever. Tab Limited has an extensive responsible gambling policy which has been approved by the NSW Minister for Gaming and Racing and with which the standard form PubTAB contract requires all hotels to comply.



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## 7 Economic analysis of the merits of the application

An economic analysis, prepared by NECG, of the wagering and racing industries in NSW and the likely impact of the proposed conduct (if authorised) on economic efficiency is appended in a separate report. The main points made in that analysis can be summarised as follows.

### 7.1 Economic characteristics of wagering

It is useful to start by considering whether the services provided by Tab Limited and SKY face pricing disciplines associated with substitution to alternatives.

Econometric evidence on the price elasticity of demand for gambling or wagering or the cross-price elasticity of demand between different types of gambling is limited and possibly unreliable. The Productivity Commission has suggested that total demand for gambling is likely to be inelastic and there are good reasons to think this is likely to be true. However, for present purposes, the more relevant issue is whether demand for wagering is price elastic and how substitutable different forms of gambling are likely to be. There are good reasons to believe that, at least in the longer term, demand is likely to be elastic as a result of substitution between different forms of gambling. While the increase in consumption of new forms of gambling has in large part been reflected in an increase in total gambling, there has also clearly been a reduction in the level of real per capita consumption of wagering, while per capita consumption of gaming has increased. Moreover, it can be seen that the racing and wagering industries have been able to maintain demand at these levels only by increasing the quality of the racing and wagering products available to consumers and the quantity of racing on which wagering is offered (which is equivalent to a price fall). Accordingly it seems clear that Tab Limited's conduct is constrained, at least to some degree, by the activities of competing gambling service providers.

The manner in which Tab Limited and SKY are structured and operate in the face of these constraints needs to be understood in the light of specific features of the industries in which they operate. Racing is essentially a "gambling industry", generating most of its economic benefits through the activity of gambling, rather than as a spectator sport. Racing is also a public good, characterised by the absence of opportunity costs in consumption and difficulties in excluding people from its consumption. This combination of characteristics has been recognised in the statutory arrangements for the organisation of the racing and wagering industries, in NSW and in other states. Tab Limited has been provided with an exclusive licence to conduct off-course totalizator wagering in NSW, but is price regulated and is required to provide the majority of funding for the NSW racing industry. Furthermore, it faces a degree of current competition from inter-state and international wagering operators. Importantly too, the NSW racing industry is organised on a not for profit basis, so that all revenues are ploughed back into the production of racing output.

SKY Channel is an important complement to wagering, and may be conceptualised as an "input" into its production. It is estimated that SKY Channel

coverage boosts wagering consumption in the order of 40-60 per cent. SKY Channel does not have any statutory exclusivity and is not price regulated. While it currently has no direct competitor in relation to the broadcast of live racing coverage in TAB outlets, there is clearly potential competition.

## **7.2 The distribution of wagering and SKY Channel**

Increasingly, Tab Limited has used hotels and clubs (as well as the telephone and Internet) to distribute its product to consumers. As well as providing a distribution service for Tab Limited, provision of PubTAB and SKY Channel facilities boosts the entertainment value and hence overall revenues of hotels.

Given the pricing constraints that operate on Tab Limited, it is generally in its interest to maximise the consumption of wagering and the distribution of PubTABs, as long as they add to total earnings and provide a satisfactory return on invested capital. While SKY is not price regulated, the primarily fixed cost nature of its operations, combined with its ability to price discriminate between hotels on the basis of the value SKY Channel provides to their business, means that SKY too faces incentives to maximise distribution of its service.

In short, though Tab Limited and SKY have exclusive rights, they face constraints associated with substitution. Even more important, they are in a position to price efficiently, in the sense of minimising the allocative distortion involved in their raising of revenues (including whatever profits they can obtain).

## **7.3 Relevant economic characteristics of hotels**

Hotels operate in markets which are differentiated in product and geographic space. Wagering is a relatively minor part of their business, at least on a stand alone basis. While gambling is increasingly important for the viability of hotels, this principally takes the form of gaming (or poker) machines rather than wagering. Whereas Tab Limited faces incentives to maximise racing and wagering output in order to maximise profits, given its price regulation, the same will not be the case for hotels individually and is not likely to be for hotels collectively. If they are able better to exploit the existing base of customers to benefit themselves, even if this means a long term reduction in the total output of racing and wagering, they will likely do so.

## **7.4 The Application and the economic impacts of authorisation**

AHA's application for authorisation of price fixing and primary boycott conduct in relation to Tab Limited and SKY is likely to result in a transfer of income from Tab Limited and SKY to "infra-marginal" hotels, who will seek to use the proposed conduct to increase PubTAB commissions and decrease SKY Channel fees. "Marginal" hotels are more likely to opt out of the collective bargaining process, in order to retain their PubTAB and SKY Channel services, which contribute to the overall value of their business.

Any increase in commissions or decrease in fees will have limited impact on the overall revenues and costs of hotels. Even if this reduction was fully passed on, the gain in efficiency would be extremely small. Additionally, since competition

between hotels is limited and SKY Channel fees are essentially part of the hotel's general overhead cost, there will be no impact on the marginal cost of beer and prices have been seen to be sticky downwards in the industry, there is good reason to question whether the changes will in fact be passed on to consumers. Rather, the most likely impact will simply be to transfer income from Tab Limited and SKY to the owners of hotels, in particular, "infra-marginal" hotels.

Authorising conduct that results in mere transfers of income is undesirable as it encourages wasteful rent-seeking activity. In this case, authorisation would not merely legitimate rent-seeking but would also result in distortions to productive efficiency and to the allocation of resources.

An increase in commissions is likely to result in some adjustment to Tab Limited's use of different distribution streams, shifting output to less efficient distribution streams and hence reducing overall productive efficiency.

Further inefficiencies will arise as a result of reduced payments to the NSW racing industry, initially through the WIF and subsequently through the "product fee" as the reduced quantity and quality of racing has further repercussions for wagering turnover. Since the NSW racing industry is organised on a not for profit basis, reduced revenues will directly impact on the quantity and quality of racing output. While Tab Limited faces incentives to increase output towards the socially efficient level, this is not the case for the hotels, who can benefit from increased commissions on a reduced base of consumers.

The viability of small and rural hotels is not likely to be promoted by the proposed conduct. Neither TAB Limited nor SKY faces incentives to restrict the viability of marginal hotels and the current tiered structure of PubTAB commissions and SKY Channel fees actually promotes their viability. Furthermore, it will not necessarily be in the interests of hotels collectively to promote the viability of small hotels, nor of the AHA if small hotels do not represent the median AHA member.

Transactions costs will not be reduced as a result of the conduct. Rather, the process of bargaining that will be promoted is more likely to result in a wasteful use of resources as compared to the current standard form agreements operated by both Tab Limited and SKY.

Accordingly, the overall impact of the conduct will likely be a transfer of income from one group in society to another, a reduction in allocative and productive efficiency and hence no net public benefit.