

**THE PARLIAMENTARY STANDING COMMITTEE OF PUBLIC ACCOUNTS  
MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON  
WEDNESDAY 16 JULY 2003.**

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**FEDERAL HOTELS AGREEMENT**

**Mr GREG FARRELL**, MANAGING DIRECTOR, **Mr BRENDAN BLOMELEY** AND **Mr ANDREW EAKINS**, FEDERAL HOTELS PTY LTD, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

**CHAIR** (Mr Fletcher) - Thank you, gentlemen, for coming along. Could I briefly explain the way we would like to proceed. We would provide you with an opportunity, if you wish it, to speak to your submission and further expand on matters in the submission. The committee obviously has read your submission and given consideration to it. When you have taken the opportunity to speak, if you wish to, by way of opening statement, we will then proceed in as structured a form as possible to ask questions with regard your contribution in regard to each of the terms of reference. I think your submission is clear and concise and we have spent some time on that. Do you wish to make an opening statement?

**Mr FARRELL** - Thank you. Essentially what we would really like to do is put on record that we believe that the agreement entered into between the State Government and the company is one that was designed to meet the requirements of the major stakeholders. Quite clearly, the Government, through its social policy agenda, was very interested in introducing a cap on gaming machine numbers in the State. Very clearly, from the company's perspective, we saw that for the company to give us essentially the opportunity to continue with the expansion of gaming in Tasmania over the next number of years was something that would require a quid pro quo. We saw that quid pro quo in a sense being a longer term of licence being negotiated by way of this new agreement, which would then provide the company with a greater level of certainty which, in a sense, would assist in underwriting its significant tourism investment strategy in Tasmania, which no doubt is something we are fully committed to but also has a higher cyclical nature and has a greater potential reliance on external circumstances such as world events and what have you.

We saw a longer licence period as being something desirable in ensuring that our two major businesses were able to coexist for a sustainable period of time within the State. We also saw that the company negotiating to provide the State with higher taxes and licence fees essentially six years prior to the conclusion of the licence - the existing licence is due to expire on 1 January 2009 - would provide the State Government with substantial additional taxes and licence fees. Over the term of the agreement some \$55 million extra in taxes and licence fees plus an additional \$3.4 million in community support levy, plus a considerable saving to hotels and clubs participating in network gaming over the life of the agreement would provide the Government with a substantial form of income, whilst at the same time, though the company was very reluctant in negotiating to pay any additional taxes and licence fees, particularly for the first six years

of the agreement - between 2003 and 2009 - I felt that the existing level of taxes and licence fees would have been more than appropriate for that period. Only from the period when the existing licence was due to expire should the company pay additional taxes and licence fees. However, at the end of the process, we agreed on the basis of a gaming machine number in the State being capped at 3 680, some almost 300 greater than the existing number, that we would pay the additional taxes and licence fees from 2003 rather than 2009.

The reason behind the number of gaming machines extra under the cap of some 300-odd was substantially less than we originally felt was appropriate for the State. At the same time, we clearly understood the objective of the State Government to place a realistic cap on the number of machines and the penetration of machines within the Tasmanian community. We also, though, were very much of the opinion and negotiated to the extent that there would be sufficient flexibility in the number of machines in the State to allow the company and the large number of committed hotels and clubs that have spent substantial sums of money on capital expenditure and investment who in the future could have the opportunity to increase the number of machines under the present hotel and club cap: up to 30 in a hotel and up to 40 in a club. In the event that their businesses were able to justify an increase, we would be able to have the product available to assist them in meeting that objective, which in a sense was supporting the level of commitment and investment that the hotels and clubs have made in this State over recent years. That is why we wanted to have an increase greater than the current number of machines as at today's date. We are not prepared to accept anything less than the 294 additional machines to allow that objective to be met, whilst at the same time leaving some room potentially for additional venues that could demonstrate their wherewithal to be appropriate gaming venues to be brought online who at the same time would not have a substantive negative impact on other gaming venues within their immediate vicinity.

We believe that the agreement negotiated between the company and the Government in a sense was the best possible outcome the State Government could achieve whilst getting an agreement from the company. There was no more blood to be squeezed, no more machines to be cut, no less time that we would agree for the additional licence period. At the end of the day, we essentially came to a position to say that there is no more room, we either can find an agreement within the terms of the Government we find acceptable and those terms which the board of Federal Hotels would find acceptable. That is what essentially led to the closing of the deal. At the same time, we believe that socially and politically the agreement balances the requirements of all the major stakeholders in the State.

**CHAIR** - Could I just seek to clarify the structure of the organisations we are dealing with here today? Is it right for me to conclude that Federal Hotels and Network Gaming are wholly-owned subsidiaries of a closely-held company, Australian National Hotels?

**Mr FARRELL** - Yes. The parent company is Mulawa Holdings.

**Mr EAKINS** - It is actually the other way around: Mulawa Holdings is the parent company. It owns 100 per cent of Federal Hotels Pty Ltd which in turn owns 100 per cent of Australian National Hotels Pty Ltd which is the entity that holds the licences for the Network Gaming and for the Wrest Point Casino licence. Then there is another company, Tasmanian Country Club Casino, that holds the casino licence for the northern

casino. So ANH is a subsidiary of Federal Hotels which in turn is a subsidiary of Mulawa Holdings which is the ultimate holding company.

**CHAIR** - So the casino operators in Tasmania are Australian National Hotels?

**Mr EAKINS** - The casino operator for Wrest Point is Australian National Hotels; the casino operator for the northern casino is Tasmanian Country Club Casino Pty Ltd. Both of those are wholly-owned subsidiaries of Federal Hotels Pty Ltd.

**CHAIR** - Where does Network Gaming fit into the structure?

**Mr EAKINS** - It's a business owned by Australian National Hotels. So Australian National Hotels has the casino and Network Gaming.

**CHAIR** - Yes, but it is a separate entity, a separate WHOLLY-owned subsidiary of Australian National Hotels and Network Gaming is responsible for the infrastructure and management of gaming in pubs and clubs throughout Tasmania?

**Mr EAKINS** - That's correct; they're operated as totally separate businesses.

**CHAIR** - Mr Farrell, are you the CEO of Federal Hotels and Australian National Hotels?

**Mr FARRELL** - I am actually the Managing Director of Federal Hotels and of Mulawa Holdings which is the parent company.

**CHAIR** - I think I have that structure in place now and we know who we are talking about. Perhaps we could move on to term of reference No. 1. Mr Hidding had a number of questions.

**Mr HIDDING** - I have a couple on the executive summary and raised now by Mr Farrell in his opening remarks that I think we could clean up first, if I could ask Mr Farrell. You have made, as you have said, some very substantial investments in this State over the last few years. These just pop to mind: four major hotels; the Abt railway; Strahan Village; and in July 2002 you announced Hazards at Freycinet, a 150-room development - do you consider that that investment places you in any particular advantageous position or should place you in that position in the negotiation for gaming licences in this State?

**Mr FARRELL** - I think, Rene, the answer to that is that the company has been a long-term investor in the State of Tasmania for well over 30 years and not only in the gaming industry but also in the tourism industry. There is absolutely no doubt the advent of this tourism and business cycle that we are in now was one that saw a number of opportunities for a company with vision and commitment to invest in Tasmania and to position itself further around Tasmania's significant touring market. We also saw then the potential for Federal Hotels & Resorts to create a significant new business both in tourism and also in activity-based tourism with the West Coast Wilderness Railway and the Gordon River cruises and potentially a cruise operation on the east coast.

I think there is absolutely no doubt that the current Government of the State also saw that the level of significant commitment that Federal Hotels & Resorts had made to Tasmania was one that seen as being a sign of a high level of commitment by the company to the

State and to its investments. I am sure that it did no harm to the company taking it to the negotiating table. At the same time would the company have negotiated to achieve a similar outcome we would have negotiated to, whether we would have been successful or not, is something I can't say.

**Mr HIDDING** - When did you become aware of the Government's social reform agenda to bring about a cap on the number of machines in this State?

**Mr FARRELL** - We were aware that the Government had, particularly for 2003, an agenda for social reform. I was aware, through not necessarily a specific discussion but through loose discussion with members of Treasury, that in fact there was some view about numbers of gaming machines in the State, so I can't actually put a specific date to it but some months ago then it was formalised as to would the company sit down to discuss the potential of this occurring and that took place in -

**Mr EAKINS** - April or May.

**Mr FARRELL** - And then during that period initial discussions took place and then in fact I was overseas for some little time and spent quite some time on the phone having some further discussions and negotiations to that extent which led to a new deed being signed in -

**Mr EAKINS** - The end of May, wasn't it?

**Mr FARRELL** - May, which is prior to David Crean's ministerial statement.

**Mr HIDDING** - The key point for me is understanding what your organisation understood your deal to be; after all, it is your licence to operate in Tasmania - to operate the two casinos and the network gaming in Tasmania. What did you see the 2009 expiry deal, the process, being - the normal arrangements of the expiration and the renegotiation of that deal? What did you forward diary say and what was the process going to be?

**Mr FARRELL** - In a sense it is interesting from the perspective that the company has held gaming licences continually in Tasmania since 1970 - 1973 was the advent of Wrest Point. The licence has been negotiated between that date and now on several occasions. It has never actually been negotiated on the expiry of the prior licence, so almost in every event there has been a trigger that has led to a renegotiation. In one sense, a trigger for renegotiation of the existing licences was the building of the convention centre at Wrest Point. Another trigger for the renegotiation of the licence was in 1993 - just 10 years ago - with the Groom's Government intent to licence or to issue gaming machines beyond the casinos, which led to a renegotiation for the 1993 Gaming Control Act. We felt that there would be a trigger some time between 1993 and the expiry of the licence in 1 January 2009. What that would be or how that would come about is very difficult to forecast. We saw the Government's coming to the company about this opportunity to introduce a cap as being a trigger point.

**Mr HIDDING** - If there hadn't been a trigger point could you have manufactured a trigger point? You say that has happened in the past. Could you have, for instance, considered a development to take to them to say, 'In exchange for this could we sit down and talk about the deed?'

**Mr FARRELL** - I would have hoped between now and 2009 there would have been an appropriate trigger. I don't know, what that would have been, whether that would have been a government-induced trigger or the company going to the Government. In this instance the Government wanted to achieve an outcome and the company wanted to facilitate that outcome, so there was in fact a meeting of minds. That being said, though, there is no doubt that the company's existing agreements run through to January 2009. There is a considerable period of time for the existing agreements to continue to operate and for the company to negotiate at some appropriate time for a new licence or a new set of conditions which may be more favourable or less favourable than the agreement we have just entered into.

**Mr HIDDING** - Following on from your questions, Mr Chairman, could I just explore with Mr Farrell the infrastructure of network gaming. In layman's terms, what is the company? I know there is a building at Sandy Bay: what does it contain; what is your linkage to the pubs and clubs; who owns the machines; what is the substance of network gaming?

**Mr FARRELL** - Network Gaming is run by a management team headed by John Mortonson as the general manager of Network Gaming. He has a general manager of operations, a business development manager and a number of business development executives as well as a number of call centre people. The business of Network Gaming is the provision of gaming machines and the game of keno to licensed hotels and clubs. Network Gaming acquires gaming machines from major manufacturers and places the gaming machines in licensed hotels and clubs, no more than 30 in a hotel and 40 in a club. The hotel or club then pays Network Gaming a rent which is commensurate with the costs of Network Gaming providing machines, so totally on a cost-replacement basis with no profit to Network Gaming. That provides the product to the venues. Network Gaming has a monitoring system which monitors the machines continually over every 24-hour cycle, ensuring that there are no significant events or actions that would lead to either the machines malfunctioning or inappropriate access to the machines by a player or staff member.

**Mr HIDDING** - Could I ask a really dumb question here: does each machine have its own central logic as to payouts and the rest of it or is that centrally -

**Mr FARRELL** - Each machine does have its own logic. Each machine has a game and that game has a game chip. The Gaming Commission has a master chip which is verified against the chip that is in the machine to ensure that the mathematics are identical. That covers the way in which the machines payout.

**Mr HIDDING** - But is each machine then linked to -

**Mr FARRELL** - Each machine is linked and each machine -

**Mr HIDDING** - And that can be monitored?

**Mr FARRELL** - Yes, each machine is linked to a host computer in the site and then that site computer is linked back to -

**Mr HIDDING** - In the site?

**Mr FARRELL** - In each venue, and that is linked back to a central computer. The central computer room in Network Gaming is in a very secure environment. There is no access by unauthorised personnel; it is continually monitored, and the Government monitor what we monitor.

**CHAIR** - Just to add to that, the linkages are fibre optic or secure phone lines?

**Mr EAKINS** - It is straight through the phone lines but it's encrypted data, so that there is a security package that goes backwards and forwards between the host computer at Traveller's Rest and the site computer.

**CHAIR** - So there is no underground structure or infrastructure of any nature of fibre-optic cables linking them?

**Mr FARRELL** - No. There are fibre-optic cables within the venues but we use the telephone lines with the encrypted information for access between venues.

**Mr HIDDING** - So you've got deals with Telstra?

**Mr FARRELL** - Yes, we're one of Telstra's largest users in the State - unfortunately.

**Mr WILKINSON** - Greg, can I get back to what you are you saying in relation to triggers. In most agreements there is an option period to take up an option or otherwise. I hear what you say in relation to a trigger, that you would hope that prior to 2009 there was going to be a trigger in order for you to renegotiate. In order to take up that agreement there has to be something in it for you and obviously something in it for the Government, in plain terms. Can you summarise what was in it for Federal Hotels, strictly in a business sense?

**Mr FARRELL** - In a business sense, quite frankly the only benefit for Federal Hotels was the extension of the licence period, which would provide the company with a greater degree of certainty about its business position going forward, allow for its investment decisions in new and existing businesses, and enable it to better plan to meet its forward capital expenditure requirements. There is no doubt that our financiers, the ANZ bank, saw the outcome of a longer licence period - even though we were paying additional taxes and licence fees - as being something which they saw as being very supportive of the company's tourism and investment strategy, which quite clearly is more cyclical and, I suppose, has more risk and is perhaps less generally bankable than many other businesses in Tasmania. They saw and we saw that the longer licence period would help provide the company and its financiers with a greater ability to see that the company would be able to ride out any storm that may appear through events unbeknown to the company in the future, and to meet what we see is our vision for tourism investment strategy in the State. We also believe it will provide, hopefully, long-term benefits not only to Federal Hotels and its employees and stakeholders but also to the State.

**Mr WILKINSON** - Was there any concern that in 2009 the licence might have been continued?

**Mr FARRELL** - Jim, in my mind the likelihood of the licence not being continued is extraordinarily remote. The likelihood of a government deciding that the potential for competition should exist, which might be another operator or another two operators, is always there. So what that would cause at that time would no doubt be a greater level of uncertainty in business continuity. From our perspective, that was an undesirable outcome for a number of reasons. It is an undesirable outcome from the perspective that Tasmania is a very small region in which to have gaming machines; greater levels of competition between operators would no doubt, in our view, lead to higher levels of adverse marketing and promotional campaigns and to greater competition between venues and operators, which in our view would be likely to lead to the more vulnerable in society being coerced into doing things which they may not wish to do. We saw that the one-operator model was the best model for Tasmania. At the same time, though, there was always the potential that the Government of the day may decide that for income purposes or whatever that a two-operator model may be more profitable.

**Mr WILKINSON** - Were you aware of another operator 'sniffing around'?

**Mr FARRELL** - No. There is no doubt in my mind that by 2007 or 2008 there would have been more 'sniffing around' than there was in 2003, so there is no doubt, I think, that by moving earlier than we could gazump that potential to some extent. Having said that, I think it would be entirely the wrong move by any State government to introduce in this socially-sensitive area levels of competition that could adversely affect the community. We are very proud of the way in which Federal Hotels and Network Gaming have managed gaming in this State beyond the two casinos. We are very proud of the way in which Country Club and Wrest Point have conducted the responsible way of introducing gaming to the community since 1973 at Wrest Point and 1983 at the Country Club.

**Mr HIDDING** - And rightly so. We have come down to, by this question asked by my colleague, a key point of where I want to go with this this morning. You have addressed the competition aspect from the aspect of someone else coming in and running poker machines alongside Network Gaming and therefore you couldn't talk about a cap or whatever, but is it not true that the licence to operate machines in pubs and clubs is not about another operator coming in, it could also be about someone else other than Federal being granted the licence to run Network Gaming in this State?

**Mr FARRELL** - That could well have been an outcome. However, at this point in time the probability of that outcome is low. I felt that a greater probability would have been for another licence to operate to compete against the company as opposed to taking the licence we have.

**Mr HIDDING** - What was your judgment there? Have you ever heard either side of politics ever talk about another operator in there? We are only a small State. I have never heard anyone say it.

**Mr FARRELL** - To take the licence away from Network Gaming and to provide it to another party, we would argue it would provide an environment to take the casinos back to the taxation positions that related to them prior to the 1993 Gaming Control Act. At the moment the two Tasmanian casinos are essentially the second-highest taxed casinos in Australia, where back in 1993 they were reasonably taxed. If the company continues to operator in an appropriate way in the community we believe that outcome is remote.

**Mr HIDDING** - Okay, and it looks remote now in 2003. But given that in 2008, say 12 months out from the expiration of this deal, whichever government was in power at the time, it had a duty to sit down and renegotiate or look at the value of its licence that it was about to grant to somebody, to consider whether there was another player who was prepared to pay substantially more money - someone prepared to have a big punt on taking you on for the right to run pokies in pubs and clubs - and that government may well have judged that extra income against the drop in income from the casino. In three or four positions in your submission you refer to substantial danger to your organisation from competition over the horizon. Could you see another operator taking over the right to run machines in pubs and clubs? You own the machines, don't you?

**Mr FARRELL** - Yes, we do.

**Mr HIDDING** - So if you lost that licence, let us say there was a major breach or something or other, hypothetically if you lost the licence tomorrow, a new operator would have to come up with machines and offer them to various pubs and clubs and come up with a process to allocate and the Gaming Commission would have to go through all that. But another operator could in fact do what you are doing. There is nothing stopping another operator doing what you're doing, is there?

**Mr FARRELL** - No. We very much believed that the alternative model was probably to introduce another operator of gaming machines in the State whilst Network Gaming still retained its licence. I think the probability of saying to Network Gaming, 'You no longer are a fit and appropriate person to hold the licence' is extraordinarily remote. Having said that, then our view was that if that was going to be the case and if the Government had said that was going to be the likely outcome in 2009 if the Government was in power at that time, we would then have to run our business in a very different way and which is a point we have made in our submission and the point we very much made to the Government.

**Mr HIDDING** - 'Fit and proper thing', we probably shouldn't go there because it is a nonsense argument, given your track record in the State. If there is to be no genuine competition for your exclusive licence to run machines in pubs and clubs in Tasmania, have you then not a licence for life to run that?

**Mr FARRELL** - No, because at the expiration of the licence that has been negotiated with the Government, the Government can serve notice on the company that in fact the licence condition is going to change in any manner in which the Government of that time saw fit.

**Mr HIDDING** - Can't they just agree not to give it to you? Could they sit down, for instance, in 2008 with Tabcorp, Tattersalls, whoever - I have no idea who is out there because I am not in the industry -

**Mr FARRELL** - Sorry, I missed it. The point there really though, Rene, is that at this point in time the Government has no influence between now and 2008 on how the company conducts its affairs in relation to rolling out gaming machines. The Government wished to introduce a responsible cap on the number of machines and to do that it had to negotiate with one party and only one party, which was us. The cap is the issue and the cap was the overriding objective of the Government and was the key issue that Federal



Hotels was prepared to give up plus it was prepared to pay a substantial additional tax on the licence fee for the extension. This whole issue resolves around the Government's intention to introduce a socially responsible cap on gaming machines.

**Mr HIDDING** - For the next six years?

**Mr FARRELL** - No, not for the next five years - forever.

**Mr HIDDING** - It could have done that forever at the expiration of it.

**Mr FARRELL** - However the number of machines in the State would likely have been significantly different to the number of machines that are capped today so the 3 680 cap the Government negotiated would not be the cap that it would be negotiating in 2008 or 2009 - it could be 4 500 or it could be some other number - so the Government took upon itself to bring forward a negotiation, in our view, to responsibly address the issue of gaming machine numbers in the State.

**Mr STURGES** - Mr Farrell, I think you have just answered where I was going to come from. Just following the line of questioning from Mr Hidding - and I am just referring to my notes and I think you have given a very comprehensive opening statement and also submission so I don't want to go too much further into it - you did talk about the social and the political balance which you just touched on then. You also talked about the various triggers over the last 30-plus years that have led to the deed being renegotiated prior to expiration. I don't want to keep going back over old ground but I think, just for the benefit of *Hansard*, if you could again make mention of the purpose behind the earlier negotiation, the Government's desire for political expediency and social benefits and the outcome for Federal.

**Mr FARRELL** - Graeme, clearly what the Government wished to do was to negotiate to introduce a cap on gaming machines that couldn't be achieved by any other means than negotiating an outcome with the company. It sought to negotiate a cap six years prior to the existing licence's period running out -

**Mr STURGES** - If I could just very quickly, this is not precedence-setting. Again, you made mention before that in the 30-plus years that Federal have held the licence to operate -

**Mr FARRELL** - Yes. The Government saw that this was an opportunity to realise this objective of introducing a cap. From the company's perspective, the company was amenable to discussing the cap on the basis that it would be a realistic number of machines that would be capped in Tasmania forever and also that the number of machines in hotels and clubs would be capped at 30 in a hotel and 40 in a club which, under the existing legislation, would be reviewed annually between the company and the Gaming Commission and if the two parties agreed to a number greater than 30 and 40 that would become the number, so the company also waived that potential ever occurring. The company saw that a longer licence period was the only acceptable quid pro quo for giving up the potential additional income for extra gaming machines and also agreeing to pay the Government substantial additional taxes and licence fees, not only for the life of the new agreement but for the remaining six years of the existing agreement.

**Mr STURGES** - Just one last point, if I may. Again, it is going back over where you have been but just for the sake of clarity for me and for *Hansard*. You did mention in your opening statement that this does not preclude additional venues in the future that don't have machines. Bearing in mind that we have the cap - and I would stress that - it is not going to stop new venues being considered further down the track.

**Mr FARRELL** - Graeme, that is particularly the case in the early years of the cap. There is no doubt, as the cap is going to be in place for some 20 years, that we were going to reach a stage where all the additional machines have been rolled out and then additional venues in the State would only be created by poorer performing venues having machines taken from them and reallocated to other places. There is no doubt the way in which we negotiated the cap was to enable potential new venues. Quite frankly, we see very limited opportunity in Tasmania. We believe that under this cap the number of venues in this State is about the appropriate number and that does provide the opportunity, if there are outstanding opportunities, for new venues. It certainly meets our criteria of allowing existing venues that can demonstrate their business case that an additional number of machines would be a good commercial decision for them, the community and for the company to enable us to achieve that objective.

**Mr WILKINSON** - Talking about the cap, Greg, I hear what you say: the only way that the Government could endeavour to put a cap on it was by entering into negotiations with you and saying, 'Do you mind not abiding by what was in the agreement a while ago?' Had you reached a point, though - and there has been some evidence when you look through the previous Legislative Council committee report on the gaming machines - where demand and supply were pretty well equal as they are now before you rolled out the extra machines?

**Mr FARRELL** - Jim, the answer to that is yes and no. It is 'yes' under the existing business model of the way in which we operate our business. We feel that somewhere between 105 and 110 venues is about the appropriate number of venues in the State and we have been quoted as saying that in recent years. However, there is another business model that potentially would make us substantially more money. In our view there are probably something like 40-odd venues in the State that would be desirable for installing gaming machines, which the company has not agreed to. We believe that would be a sub-optimal outcome to surrounding venues and also to the community, by having gaming in a larger number of hotels and clubs throughout the State. However, it would probably be a more successful commercial outcome for the company, which would be to give gaming machines to every venue that wants them. We have seen in the papers in recent days venues claiming it is wrong that the company hasn't provided them with gaming machines, but quite frankly if we provided gaming machines to every venue that had requested them over recent years we would have not 105 venues in the State but closer to 200 venues. We believe that in the model which we currently operate on, which we believe is a commercially responsible, sustainable way of managing gaming in this State, the number we have now is about right. However, there is no absolutely doubt that there are other business models which we could fulfil - and perhaps other operators would have if they were in our shoes - that would have seen a much larger number of gaming machines in Tasmania, a much greater penetration rate for hotels and clubs and much greater access by the community. We believe that would have led to less capital investment by venues because they would have made less returns on them; it would have

led to lower commitment to training and jobs creation in the State and it would have led to a sub-optimal outcome for Tasmania.

**Mr BEST** - In relation to the social sensitivities that you talk about and the structure of the negotiations and the outcomes in relation to the capping, are you prepared to comment in some way about how you would see that with relation to the agreement on a State-by-State basis, say Tasmania compared to Victoria or New South Wales? Would you be prepared to comment along those lines?

**Mr FARRELL** - I think, Brenton, one of the differences between the way in which Federal operates and a number of our competitors operate interstate - and I feel it is one of the advantages of being a private company - is that the company isn't in a position where it must meet market expectations on a quarterly basis, which many of our competitors do. Every quarter they have to report to the market what their earnings are, what their penetration rate is, the number of units they have out there and, in a sense, whether the business is growing or shrinking. In our case, as a private company, we run the business on the basis of long-term sustainable positions as opposed to short term and trying to meet investors' and analysts' views on a quarterly basis. In my opinion that enables the company to operate in a very different way. We take the view that the long-term success of the company is in fact measured by the long-term success of the community and it is not about hit-and-run or short-term tactics to maximise profitability. Profit is obviously very important to the company, but profit over a sustainable period of time meeting and exceeding the community's expectation. This is why the company is so active in relation to such things as responsible gaming practices. There is no doubt since 1997 Tasmania has led Australia in responsible gaming practices and there is absolutely no doubt that the Tasmanian industry, and not just Federal Hotels, I think is considered to be the most proactive and most measured in the way in which it conducts its affairs. This is one of the reasons for the high level of success and the high level of acceptance of the introduction of gaming in Tasmania since 1997, which I think has been achieved in a way that has exceeded many of the original stakeholders' expectations. I think it is not only commendable in the way in which the company has conducted its affairs, it is also I think commendable to the hotel industry, the AHA and Clubs Tasmania in the way in which gaming has been managed. The Tasmanian industry recognises this with the formation of the Gambling Industry Group. Codes of conduct and responsible advertising practices have been in place in Tasmania and managed responsibly in Tasmania years ahead of other jurisdictions that in fact had gaming 20 years before us. I think that is one of the real success stories of the Tasmanian gaming industry.

**Mr BEST** - Could I just explore this with two more points. In some ways what you are saying is that there is almost a shared philosophy in the way that the trigger occurred but there is this business philosophy about your position in the State and your social sustainability, so the trigger - being a capping - very much fitted in with your corporate -

**Mr FARRELL** - That's correct.

**Mr BEST** - In relation to social sustainability, in terms of the financial basis for the State how do you see that then? Do you see that in terms of your company getting its deal and the Government getting our deal? Again, in comparison to other States, but maybe you want to talk about just this State.

**Mr FARRELL** - The deal stacks up, in our view, very favourably. It is very difficult to compare directly legislative outcomes in various jurisdictions. In the case of Tasmania, the two casinos will be paying taxation rates on gaming machines at 30 per cent up to \$35 million and 35 per cent over \$35 million. From 2013 all gaming will be taxed at 35 per cent. How does that 30 per cent compare to other regional-sized casinos, so let us go to Townsville or Cairns - similar sized towns. They pay a tax rate of 10 per cent so in a sense we are paying three times the level of taxation that other regional-sized casinos pay.

**CHAIR** - Greg, could I just intervene there and ask from where are you drawing your statistics? Are these statistics available in the document that you provided to us?

**Mr FARRELL** - Yes, they are.

**CHAIR** - So you are quoting from that document?

**Mr FARRELL** - Yes.

**CHAIR** - Thank you very much.

**Mr FARRELL** - If we look at the issue of licence fees, Federal pays the highest licence fees of any casino or jurisdictions in Australia. The casinos on that basis, based on population, are no doubt the highest-taxed casinos in Australia. Network Gaming's tax rates are commensurate with the tax rate regime held by Tabcorp and Tattersalls in Victoria. That is for a major market of some 3-plus million people.

On a direct taxation basis there is argument to say that the Tasmanian gaming industry I think is more than appropriately taxed. It was a point I was making ad nauseam during the discussions with the Government some months ago. We think that on no basis is there a view that the company is paying insufficient tax. Over the length of the agreement in fact the Government receives some \$55 million in additional taxes and licence fees. As well the community support levy will be boosted by a further \$3.4 million by the company agreeing to pay 2 per cent of the revenue generated by clubs to the community support levy, making it 4 per cent, which is the same as the hotels support the community support levy.

On the basis of taxes and licence fees there is absolutely no doubt in my mind that the Crown negotiated a very good outcome. In fact, as I said earlier in the opening statement, we got to the point of saying there is no more blood to squeeze unless you are going to look far more favourably on the length of the licence. In a sense we have to try to weigh up against then moneys expended in taxes and licence fees against the ability of the company to meet its other objectives. One is that businesses must be sustainable and viable for the owners. They also must be able to meet and assist in providing the wherewithal to carry out our vision for the creation of new businesses, which is particularly relevant to our Tasmanian tourism investment strategy.

**Mr WILKINSON** - There was an article in the *Mercury* today - I just read the headline and I didn't read it through; Nick Clark wrote it - in relation to somebody saying that the moneys that are paid by Federal to the Government are far less than they should be - I

forget the exact figures that he used. Have you read the article? This is an opportunity to refute it or otherwise.

**Mr FARRELL** - I only had a chance to skim the article just before I came in - somebody put it on my desk - and I thought, 'Boy, that's timely'.

*Laughter.*

**Mr STURGES** - What a coincidence!

**Mr FARRELL** - In reality, analysts can look at the business in an myriad of ways. I have no idea what sort of analysis they tried to put forward on it. I think they made a reference to Tabcorp and Tattersalls and some other analyst's view about what the potential value of licences in Victoria were where the incumbents are sharing 27 500 gaming machines. To me it is totally irrelevant; it is like comparing apples and oranges. The agreement which the Government has negotiated in our view stacks up extraordinarily well, based on any sort of financial parameters. What we have provided at the back of our report is an index which lays out the taxes and licence fees applicable to other casinos and jurisdictions.

I think probably one issue to note is that in some instances where casinos or gaming organisations have paid premiums for licences what we have always argued is that we would rather see the company being able to incur significant levels of investment which are going to be of benefit to the State over the long term than to pay premiums to government which might be expended in any number of ways. It has always been our view that every undertaking the company has ever made to any government or any corporate body in Tasmania is met. What we would rather do is continue to invest in the State and invest in the way we are committed to, as opposed to being put in a position where the potential wherewithal to do that is actually directed to the Government in taxation or licence fees, which we believe would have been inappropriate and we would not have agreed to it.

**Mr EAKINS** - Just another point there: analysts are analysts and they could look at the business in its isolation but the reality is in a Tasmanian situation it is not an isolated business; it is entwined with the other two casinos and, as Greg said before, that is why we are paying additional taxes on gaming machines in the two casinos over and above what we paid in another State. As I say, we have not looked at the analyst's report but no doubt they've looked at it as a stand-alone business whereas ours is a much more integrated model.

**Mr WILKINSON** - Moving on from there to the benefits the State get as a result of the new licence. We have spoken about the increased taxes and also spoken about, just briefly, the Coles Bay development. Was that development going ahead anyway or were you considering it anyway?

**Mr FARRELL** - The company announced that it had an intention to develop. We had acquired the site and we had an intention to develop the Hazards at Freycinet. There is absolutely no doubt though, and I touched on it earlier, that the agreement with the Government assists no doubt in the ANZ, our chief financier, having the confidence to continue to support the company with its objectives. There is absolutely no doubt that the new agreement allows us to have the support of the bank to build something which

we believe will be of a defining quality or a world-class tourism development for the company and for Tasmania and it also then, in a sense, allows the quality for that development to be maximised. So I guess, Jim, I could say it in two different ways. We could build a very good development at Coles Bay and we could do that for anywhere for a fraction of the cost of what we intend to do and we would probably have a lot lower risk and probably it would be commercially successful. Would it fulfil the vision that this company has for the future of Tasmanian tourism and would it fulfil the potential of Tasmanian tourism from a positive perspective? No. In fact I had the ANZ on site at Coles Bay last Friday and very much on the same basis as showing them the vision for the company, showing them the plans for the development and in a sense I came away with them highly excited and totally committed to what the Federal Group is on about with its combination of its interests in the casinos and network gaming and its tourism investment strategy.

**Mr WILKINSON** - Employment as a result of the development up there?

**Mr FARRELL** - We are anticipating the high season employment to be about 180 people. That is directly with the resort, that is not directly with a large number of other providers of tourism activities and infrastructure that will be actually supported by the resort, so we see the Hazards at Freycinet will have a significant impact on Coles Bay. We concluded, Friday week ago, the acquisition of Churinga Farm Cottages on the basis of developing that into staff accommodation which will ultimately house between 40 and 50 staff on a full-time and seasonal basis. That alone will be a significant stimulus to the Coles Bay, Swannick, Swansea and Bicheno region.

**Mr WILKINSON** - Are there any other developments as a result of the agreement which you have entered into you are considering proceeding with? I am looking for the benefits. We have spoken about the benefits to Federal and I am looking at the benefits to Tasmania now.

**Mr FARRELL** - I can say that the company has a very strong watching brief. We don't believe that our tourism investment strategy will necessarily be totally met by the Hazards at Freycinet and we believe there are one or two other opportunities in the State that the company will be very interested in being involved in and that will likely be seen out in the years to come. The company has very much tried to associate itself with the quality end of the market. It has also very much based itself around what we see as the very good strategies adopted by Tourism Tasmania, which is the hubs, clusters and travelling route strategy. We do an enormous amount of research. We have our wonderfully committed team of marketing people and, in a sense, what the company has always tried to do is do a hell of a lot of planning, a lot of research and we try to execute very quickly.

**Mr WILKINSON** - Talking about benefits again, there was word in the community that part of the deal - and please tell me if I am wrong - was the Abt railway was going belly-up, the Abt railway had problems financially and one of the only, if not the only, company that could really get it out of the mire and make it worthwhile as a paying proposition would be Federal. I am the Government, I say part of increasing the length of the agreement is that you take over Abt and make it work. We know that you can make it work and you are probably the only ones that can make it work because otherwise we are going down the tube with it.

**Mr FARRELL** - I can say categorically, Jim, that that was not the case. On 1 April the company acquired Strahan Village and Gordon River Cruises. I had met with Roger Smith prior to that but had shown little interest in the business opportunity because what I felt was that, prior to the acquisition of Strahan Village and Gordon River Cruises, any interest the company was seen expressing in the railway probably would have only inflated the price of the other assets. So on the same day on which we paid for those two businesses, 1 April, Roger and I actually for the first time went over the full track together and then started assessing the business opportunity.

We spent five months in negotiations over that business opportunity. There are probably a number of aspects to it. There is absolutely no doubt that at one time we saw it as a tragedy in the happening. I mean that, the actual infrastructure and money that had been invested by Federal and State Governments was significant. Roger had no doubt I think a wonderful vision. There was absolutely no doubt that was turning into a public relations disaster and operationally no doubt was having a number of negative effects which were affecting consumer confidence. There was also no doubt that if we could demonstrate internally to ourselves there was a business case that would see that the whole as greater than the sum of its parts, meaning the operation of the railway, the operation of Gordon River Cruises and a further increase in the infrastructure at Strahan Village - we subsequently built another 41 rooms, taking it now to 141 rooms on site - if we could get the three businesses working from a timing perspective and a packaging perspective, that could be very advantageous to the positioning of Federal Hotels. So ultimately we were able to negotiate a commercial deal with Roger and sought the agreement of the State Government to the signing of the leases, so the State Government was not involved with that negotiation whatsoever. We took over the railway on 1 August last year and commenced full operation of services between Regatta Point and Queenstown on 27 December.

If you said to me, 'Was the State Government feeling positive about the company for undertaking all it did', I think there is probably no doubt that they were. From the day we took it over we kept the existing management team from the railway and also put in a number of our own people and processes, independent consultants, and I am very proud of the way that it has gone. We have been operating at 99.8 per cent reliability. We have now carried 39 000 people. We have, I think, dramatically reduced the level of dismissiveness and scepticism in the community. The public opening by John Howard earlier this year was an outstanding success. We have integrated it into our businesses. It works like a hand in the glove with Gordon River Cruises to such an extent that we are currently commissioning and have half built a new 32-metre catamaran to replace the Lady Jane Franklin at Strahan - which is a 25-metre catamaran - to allow us to carry an additional 70 people in the lower deck and an additional 16 people in the premium upper deck. This will better balance what we see as a demand between the two businesses. As well, we are about to introduce for this season a first-class service on the West Coast Wilderness Railway. And does the State Government feel that we have done a good job? I am sure they do.

**Mr WILKINSON** - Can I ask your employment over there?

**Mr FARRELL** - We employ 38 people directly on the railway, and then a large number of subcontractors. They are very labour intensive businesses. In a sense the business

model is interesting because it is one which has similarities to a very different industry like cinemas, but the railway is very expensive to operate. It has huge fixed costs. It has large maintenance costs and it takes a substantial amount of fine tuning to make sure that you are operating it at optimum efficiency. There is also the very high cost of diesel. We believe that we can run the railway as cashflow positive, but the profitability - like many other businesses, like cinemas - is more likely to have come out of souvenir and food and beverage sales, which would then become the icing on the cake. It is very much like the cinema business.

**CHAIR** - Gentlemen, I have to remind my team that we should stick as close as possible to the terms of reference otherwise we are going to be here at five o'clock this afternoon chatting about the Abt railway and the beauty of the west coast of Tasmania.

*Laughter.*

**Mr STURGES** - Mr Chairman, I will try to say focussed on the terms of reference. I think the line of questioning that I want to pursue is consistent with where Mr Wilkinson has been: we've had a nice journey up to Freycinet, trotted over to the west coast - a very pleasant journey.

**Mr WILKINSON** - But they are the benefits for the State.

**Mr STURGES** - Term of reference (a): 'the new deed between the Government and Federal Hotels and its return to taxpayers' - that interests me. I go back to comments that you have made about the social and economic balance that has been struck in this new deed of arrangement. What would be your estimate on the number of jobs? I also take into account that you mentioned that you are maintaining a watching brief. That is very hearting to hear, by the way, that you're not just going to shut up and stick with what you've got. Taking into account that we are talking about a fair time into the future - and you have already mentioned some of the initiatives that you have taken outside of gaming - what sort of jobs are you looking at delivering for Tasmania? You have already delivered, but what numbers are you estimating over the term of the deed? I am talking direct; I understand that there is also a number of indirect jobs - you've spoken about the tourism and so on.

**Mr FARRELL** - Graeme, it is really hard to answer that directly because it will depend on how successful we are and the new opportunities. We also intend to commence a cruise boat operation on the east coast, which will be above that of the 140 to 180 employed seasonally at the Hazards. Hopefully we continue to be successful with the operations of Strahan village and that will lead to further rooms being created. We have a strong vision for some future significant improvements to both Wrest Point and the Country Club Casino. At this moment the front accommodation block at the Country Club is being refurbished to the highest standards in Tasmania, with eight of the best suites in Tasmania, and some very good corporate and leisure rooms. That is providing significant employment right now for a large number of builders - Matthews in Launceston. We now employ some 2 000 people in the State and we are the largest taxpayer in the State. Not only that, we are the largest private provider of marketing funds in the State - second only to Tourism Tasmania - which we see as only appropriate. What we try to do wherever possible is to align our investment in marketing to that with tourism to ensure that we are maximising the bang for the buck, so to speak. There is no



doubt that the company has a very high relevance to business interests in Tasmania, that the new agreement with the State supports the confidence and the commitment that the company has shown to Tasmania. There is absolutely no doubt that if it were shown that a significant part of our business was likely to be eroded in the next four or five years or so, then the company's investment decision strategy in relation to Australia and overseas would have to be different from what it is now.

**CHAIR** - Greg, I want to go back to the caps situation again and examine that. I am going to reach a conclusion and ask you to accept it or reject it. I draw my conclusion from the fact that, in your submission, what you have said earlier on with regard to social responsibility in the community and the evidence that the gaming commissioner gave under oath to an earlier committee of inquiry from the Legislative Council and evidence you yourself gave in relation to that earlier inquiry and also the fact that the cap has been set at an increase of 8 per cent, I think, or thereabouts, a relatively minor increase over an extended period of time, which leads me to believe that the marketplace said that, according to certain conditions, it is pretty much in balance at this stage and there is not considered to be much movement. Am I right to conclude that the only reason to introduce a statutory cap to the number of gaming machines in pubs and clubs in Tasmania is as a hedge against a future decision of Federal Hotels to change its business model?

**Mr FARRELL** - The future seen by Federal Hotels in relation to changing its business model would be based on any level of uncertainty about what the future would look like. There is no doubt as time progressed between now and 2009, depending on the level of uncertainty, the company would have to change the way it behaves to best position itself.

**CHAIR** - You committed earlier on to the business model and said that is the socially responsible thing to do and YOU are committed to that. As long as you remain committed to that business model surely there is little chance, given the evidence that has been submitted to this and other inquiries, for a significant growth in the number of gaming machines in clubs and pubs.

**Mr FARRELL** - That would be really, Tony, the accountant's values. We would have to be comfortable in ourselves of the likelihood of the circumstances continuing in the future that provided for the existing model to be in place to continue, which is what the new agreement does. The new agreement provided the company with the level of certainty for the extension of the licence to provide it with underwriting the existing model. In the event that we didn't have a new agreement then at some point in time we would have to say to ourselves, 'What is the likelihood, the probability of things occurring in the future?' and we would have to adjust our business decision and the way in which we run our businesses accordingly.

**CHAIR** - But isn't the truth in regard to the narrow aspect of capping the statutory obligation imposed in the new deed limits your capacity to change your business model to a far more aggressive model rolling machines out into every hotel and club throughout Tasmania, which was your alternative strategy?

**Mr FARRELL** - It takes away that option entirely and replaces it with the longer-term licence period.

**CHAIR** - That's right.

**Mr FARRELL** - The alternative was that in a sense if the Government hadn't approached the company we would have continued to operate and at some point in time we would have decided what is the level of probability of achieving certain outcomes and we would then have to make commercial decisions about how we operate our business to best position ourselves for what we would have seen at the time as the likely outcome.

**CHAIR** - Yes, but according to your evidence to us and evidence to other committees previously, you would have to abandon your level of social responsibility, your corporate social responsibility to go down that path, wouldn't you?

**Mr FARRELL** - We would have to say another business model which would perhaps satisfy the number of hotels and clubs that perhaps would like gaming machines that haven't got them is a better model to pursue for an outcome than the current model which in a sense leaves the company's flank exposed, so to speak. In a sense, at the moment we are operating in a way in which we do have a flank exposed. The new agreement closes that flank in and it continues by replacing the cap in place and the longer licence period. If the flank was continued to be exposed there is only so long you would leave your flank exposed before you did something to cover it up. We have been in business for a long time and I very much hope I am in business for a lot longer. We continue to have to assess our risk and we would only leave our flank exposed so long and we would have to do something about it.

**CHAIR** - The point I am trying to make, there was some debate about social responsibility at an earlier time and that created in me this need to clarify the position. It seems to me that given the evidence in your submission and at other times with regard market activity and given your corporate commitment to social responsibility, give or take a couple of hundred machines, the market is presently in balance.

**Mr FARRELL** - Given the current business model?

**CHAIR** - Yes. And the current business model is based on the corporate commitment to social responsibility so that the only way that is going to get out of balance, unless there are a lot of other extraneous matters which we are going to consider, but in the present climate the only way that is going to get out of balance is if Federal Hotels should abandon its commitment to corporate responsibility, social responsibility.

**Mr FARRELL** - I would put it another way.

**CHAIR** - I want to put it my way.

*Laughter.*

**Mr FARRELL** - I would put it that if Federal Hotels saw that from a commercial perspective it was better placed to operate its businesses in a different way as to mitigate against the risk of having its flank exposed because I think, very much coming from what Graeme mentioned earlier, that in a sense the agreement, and which is why we agreed to the cap - we believe is a reasonable outcome for Tasmania to have a cap and we also believe that if it does then take away the risk of the company having to change the way in which it

operates at some point in time in the future to reflect the potential of a different outcome from a legislative perspective.

**CHAIR** - You haven't explained that to me. I don't understand that. If the market is in balance, and you have explained to us also earlier in your evidence that your corporation is best advantaged if the end users in the clubs and pubs are viable business operations and return a satisfactory level of revenue to the operator, so you have got that in balance, you have got your commitment to social responsibility in balance. Surely the only disturbance to that balance can be a decision by Federal Hotels to be not socially responsible?

**Mr FARRELL** - No. The disturbance in that balance would be a change to the legislative environment or likely change to the legislative environment in which we operate.

**CHAIR** - To bring in another operator, are you saying?

**Mr FARRELL** - To bring in another operator.

**CHAIR** - I am not considering that.

**Mr FARRELL** - That must be the consideration that we have and so in a sense what this new agreement does is it takes away that potential for at least the life of the agreement to allow the existing model to continue throughout that period.

**CHAIR** - Could you explain to me then the linkages between the capping, which is socially responsible, and the decision by a future government at some stage to bring in another operator? I don't see the linkages there at all.

**Mr FARRELL** - The linkage really is that the company's existing business model is based on the fact that it is a sole operator and it is based on the fact that the business model is one that has been established to operate in coexistence with the company's investment strategies and with the two casinos. In the event then that the company was of the view, either formally or informally, that the legislative environment in which it operated was one that was going to become far less advantageous to it and the likelihood is that it would have an erosion of market share by an introduction of competitors or what have you, then the only prudent way for the company to operate would be to mitigate against that risk.

**CHAIR** - Yes.

**Mr FARRELL** - And the only way it could mitigate against that risk is to change the model on which its business is based.

**CHAIR** - Yes.

**Mr FARRELL** - And it would have to do that.

**CHAIR** - But given for the next six years that there is no other competitor and Federal Hotels are a socially responsible good corporate citizen and the market is in balance, there is little potential for change during that period, is there?

**Mr FARRELL** - That would really depend on what we saw as being the likelihood of a change of environment post that period because in reality what we would have to do, in our view, is prepare ourselves for what we would see as the risk-adjusted base of what would be the likely outcomes, whether they were outcomes that we were informed were going to occur or ones that we concluded were going to occur based on a reasonable set of assumptions.

**CHAIR** - It is a question of the capping.

**Mr HIDDING** - We are drilling down now I think into the key point of the whole thing and I think the concerns that appear to be expressed in the Legislative Council and certainly elsewhere are, I guess, the non-transparent or the non-contestable nature of the deal. I have to say from your point of view it is perfectly proper and normal for you to seek that as an outcome. What we are not testing here is whether that is a good thing for you. We are testing here whether this is a good thing for the people of Tasmania. The cap is being promoted by the State Government as the key point, the big win for Tasmania, to allow you to gazump your competitors to either not allow another operator in - which I have never heard of or considered as being a possibility until I read it in your submission - but probably more so in my mind for you to not lose the licence to run network gaming. You have it, you could lose it. I don't think that quite computes on casinos - you have it, you could lose it, except you own the two casinos. That is a little less ephemeral than the right to operate network gaming.

The Legislative Council now has to consider, after this inquiry, whether the Parliament will sign off on granting you the rights to run network gaming for the next 20 years. I have calculated that the rights to do that and to run the two casinos, in gross profit terms pre-tax, are well in excess of \$1 billion - you can work that out from the taxation numbers. What happens if the Legislative Council looks at all this and knocks back this legislation and says, 'No, we will not sign off on this new deed. Let the existing deed run its course and we will take our chances, given everything that Federal has said about responsible commercial and social levels of machines and things out there'? If you were to be knocked back in a month or two by the Legislative Council, if the deed were not to be ratified by Parliament, there is no deed and the current deed exists. You and others have talked about a possibility of some 1 500 new machines entering the marketplace. Where would you put them? Why 1 500 and not 2 500 or 500? Where does the 1 500 come from?

**Mr FARRELL** - There are two different aspects: one is that by changing the business model we would be able to put more gaming machines in existing venues. At the moment we have 105 venues; we have essentially an average of about 20 machines per venue. We have a State current cap of 30 in a hotel and 40 in a club. Every year, including this year, the company and the Gaming Commission would meet to consider what the appropriate level of gaming machines would be. In the event that we and the Commission were to believe that that number should be significantly greater than it currently is then that could be increased, but I am not taking that as relevant. If we said that there are only 24 venues currently, in the way in which we operate, that have the maximum number of gaming machines, if we were to change our business model we could easily provide a significant number of top-up machines over existing machines. If we were to do that, there would be easily 800 or 900 additional machines within existing venues. We

believe there are at least 40 venues in the State, hotels predominantly, that could accommodate gaming machines.

**Mr HIDDING** - That currently don't have them?

**Mr FARRELL** - Currently don't have them. To multiply the 40 additional venues, to provide them with maximum penetration rate of gaming machines in their community, you would exceed 1 500 easily -

**Mr HIDDING** - Why haven't those 40 got them now?

**Mr FARRELL** - Because the way in which the business model operates is about supporting quality venues in areas that have gaming machines that are committed to the principles of Network Gaming and commitment to investment in their venues. It is not about maximising the penetration rates of gaming machines in communities. In our view it is the best possible outcome, which is why we believe that gaming and gaming venues in Tasmania have such a high level of social and community acceptance.

**Mr HIDDING** - That is a very clear answer and thank you for that. Could I now explore the danger then for the Parliament in not acceding to the deed that has been signed between you and the Government. If the 1 500 new machines were to go in, how would that number of machines inoculate you against a competition in 2008 with Victorian Tabcorp, for instance, as to who should own the licence for network gaming, not a public auction but a contestable process where we are really going to find out what this billion dollar licence is actually worth to anybody? In a contestable process, why would that 1 500 extra machines give you any lead over?

**Mr FARRELL** - In our view the potential outcome would be for another operator to contest marketshare with Network Gaming and the easiest way for that to be achieved would be to make their product attractive to venues that Network Gaming didn't cater for. In a sense, what we are really saying is as part of the wrap-up of market penetration we would have to achieve we would take those venues under the fold of Network Gaming and this would make it more difficult for a new operator to take marketshare.

**Mr HIDDING** - So the 1 500 extra machines would see off any second operator. My point is, I don't believe there is any room for a second operator now, let alone after you have put in 1 500. I don't think it is in anyone's mind that there could have been two operators of network gaming.

**Mr FARRELL** - That certainly was one of the issues in my mind 10 years ago as to who and how many were the appropriate organisations. We don't believe there should be more than one operator either, for a variety of reasons.

**Mr HIDDING** - For a very good reason in that the Government of the day is talking about a cap, so they obviously don't want a second operator because they would have to give them at least two machines to operate. The Government of the day are talking about it. I haven't heard anyone else talking about more machines out there, so we are not actually talking about two operators; we are talking about someone contesting the actual licence and you losing it altogether because you haven't got it for life - you have it only to 2009.

**Mr FARRELL** - Yes. Well, we have only got the casino licence for the same period of time.

**Mr HIDDING** - Yes, I know, but it is a little easier to bat someone off, isn't it, because they have to come and build two new casinos.

**Mr FARRELL** - In 30 years we haven't lost a licence. In 30 years we have had a number of licence conditions change. Quite frankly, if the Legislative Council were to reject this agreement we would have to see that as a vote of no confidence. We would obviously then have to say 'Perhaps the way in which we have responsibly gone about and tried to manage our business affairs is not necessarily the appropriate way'.

**Mr HIDDING** - So you don't see the current deed as being a contract to have the public licence to appoint; you see it as being an arrangement that can be, at various trigger points, just renewed under better or different circumstances? You don't see it as something that allows anyone else?

**Mr FARRELL** - No -

**Mr HIDDING** - So it is a licence for life.

**Mr FARRELL** - No. Under the case of precedent what has occurred on a number of points over the last 30 years is that circumstances have arisen that have led to a negotiated outcome. If the circumstances had not occurred the licence would have run its course and negotiation would have taken its place at that point in time. Unless the company had acted in a way which was detrimental to the probity of its licence or what have you, this would have led to a negotiation of some form of licence extension taking place.

**Mr HIDDING** - So it is not open for the Legislative Council to consider Victorian Tabcorp even expressing an interest for the licence to run network gaming in this State?

**Mr FARRELL** - I think that would be more open to the Government than the Legislative Council to consider, and I think it would only be open to the Government to consider in 2008 because, quite frankly -

**Mr HIDDING** - But you are saying that that is not -

**Mr FARRELL** - If the Legislative Council reject this bill and the Government were to say, 'Because there's clearly no support for what we believe is a very well constructed opportunity for the community, the Government and the company to coexist', if the Council were to reject that the Government would say 'Clearly there's not support for what we think is the best modelled outcome'. If that was going to lead to the potential for a Tabcorp or Tattersalls to contest as a dual operator or whatever in 2009 then quite clearly we would have to consider the most appropriate way to manage our affairs, and I am sure you would have to do the same thing.

**Mr HIDDING** - Of course, and I do not think there is any question about whether some other one organisation could do it better than you people. I think what is open now for the Tasmanian people to consider is whether the best deal has been extracted in financial terms. The biggest public licence going in this State is the gaming licence. It is worth a lot of money and at this point the people have got to take your word for it - a substantial

word - that if you allow others in around the table to contest the right to run network gaming, they wouldn't get a cent more.

**Mr FARRELL** - The point here is that you can't let anyone else in. Until 2009 you can't let anyone else in.

**Mr HIDDING** - That is right. This deed, however, is in two parts. It is the remainder of this, the six years, and then another 14 years.

**Mr FARRELL** - Yes. In fact the company is providing almost \$15 million more to the crown between now and the expiration of the deed, as well as continuing to have a responsible limit on the potential for gaming in the State, not just for the next six years but for the next 20 years, and for that it has agreed for an extension of its licence period for an additional 15 years which I think, quite personally, is a very good outcome for the State, it is a very good outcome for the community and it is a reasonable outcome for the company.

**Mr BEST** - Just on that policy idea that this whole deal should be purely brokered on a financial strategy, what would be the outcome in a sense of your corporate quality policy should the Legislative Council, for argument's sake, adopt the policy that Mr Hidding has just asked you about on this financial aspect? How would that fit then with the company's quality policy and what would you see as the social ramifications bordering that? So in a sense how does it affect you with your quality positioning which I understand will change the whole market if it was just a financially driven thing that the Government was trying to extract even more money post 2008-09 and what would you see the social ramifications of that should that be the case?

**Mr FARRELL** - It is on several levels. If the Government's only requirement was to maximise its financial wherewithal and the company's only requirement was to negotiate a new licence then we could construct a model that would provide the Government with more money, the company wouldn't be able to afford to enter into any level of refurbishment or reinvestment in the State. In our view the negative outcome of that is ultimately socially and from the economy's perspective it is going to be a suboptimal outcome whereas we believe that the agreement as negotiated provides a balance between the company's and the State's social responsibilities, a significant ability and level of reinvestment in the State and creation of jobs and infrastructure as well as a socially responsible cap on the number of gaming units, not just in the State in 2003 but in the State in 20 years' time.

**CHAIR** - I have some questions with regard aspects of the decision to grant to some and not grant to others and how that might best be determined but I think I can leave that to later at the end of it.

**Mr HIDDING** - It is obvious to anybody who attends casinos that table gaming is not as attractive to people for one reason or another as it used to be, so therefore there is a lot less of it. I guess you are paying tax at a level that you and the Government both agreed was high for the cost of running it. If you didn't have a reduction in the table gaming tax, would you seriously consider pulling out table gaming? Is a casino a casino without table gaming? Would it not then just be a pokie hall?

I recognise the arguments in dropping the tax on table gaming, but what if fashions change? We are here locking this away for 20 years, what if fashions change? We suddenly go through a cycle in public entertainment - we turn the television on and everything is lifestyle shows. What the heck brought all that on? Next year there will be no lifestyle shows, we will be looking at something else. Fashions change. We are locking in a very low table gaming tax for the next 20 years - why? Why is this fair?

**Mr FARRELL** - Rene, I would argue that we are not locking in a very low table gaming tax; we are locking in an appropriate regional table gaming tax. If we compare our operations with other regional casinos - and in table gaming we can directly compare them - we commented earlier on a gaming machine tax basis, we are paying 30 per cent and 35 per cent, where Cairns and Townsville are paying 10 per cent. On table gaming tax rates, it is exactly the same - they are paying a 10 per cent tax rate and we are currently paying a 15 per cent tax rate. My argument during negotiations was pretty emphatic. We wished to continue to have to a level of table gaming presence in both casinos. At the same time though we don't wish to see the businesses being hampered by taxation measures placed against them from an operational perspective. I argue that the tax rates should be lower than in Cairns and Townsville, but we agreed to a rate that was level with Cairns and Townsville. I think that is one issue. The second issue is that you have to really look at the financial deal the Crown extracted from the company not on the basis of the components but on the basis of the sum; the sum is that the negotiation to reduce table gaming taxes was something like a \$340 000 a year potential saving to the business if we were able to achieve the similar level of revenue we achieved last year going forward.

**Mr HIDDING** - A potential loss to the Tasmanian taxpayer.

**Mr FARRELL** - On the other side the benefits to the Tasmanian taxpayer were, I think, more than compensated by the \$1 million extra immediate a year on licence fees and the \$1.5 million immediate additional in taxation on gaming machines. Over the length of the term of the agreement it is a minimum of \$55 million additional to the Tasmanian taxpayers plus the current levels of taxation and licence fees paid by the company. In our view, what we were trying to do was right the level of table gaming taxation which then better allows us, in our view, to demonstrate internally to our businesses that this is a viable and integral component of our operations. We very much wish to see successful table gaming and we work very hard at trying to ensure that we have a sustainable, entertaining table gaming product.

**Mr HIDDING** - One of the problems I have with this whole business of seeing these two gaming licences - one, the licence to run machines in pubs and clubs and the other one to operate two casinos as two separate licences - is the way that they have become, apparently, inextricably wound together so that we can't make any judgments as to the value of them. Here again you are saying, 'Oh well, don't worry about the \$340 000 loss to the taxpayer from table gaming because you're going to pick it up in poker machines'. This is this cross-pollination of the benefits from all this. In fact, on page 4 of your submission you say 'any comparison of the financial benefits of the gaming machine agreement vis-a-vis these other States would be a very difficult analysis to undertake due to the integrated way in which the pledge has been structured to cover all of Federal's gaming activities in hotels and clubs and the casinos'. In other words, what you are saying is that this deal that your organisations have with the Tasmanian taxpayer are so



intertwined that you cannot separate them out and put values to them. You have successfully managed to do it with one little aspect of it, which is table gaming, and yet you are being granted here a licence to operate casinos for another 20 years, of which table gaming is an integral part, otherwise they are not casinos, and you have managed to clip the Tasmanian taxpayer \$340 000 a year for six years in the process.

**Mr FARRELL** - I don't think that's right. Look at it in its components: the components are the rates of tax paid by the network for its revenues are at the high end of the industry's averages. The rate of tax paid by the casinos on gaming machines revenue is the second highest in Australia, only second to the Adelaide casino. The rate of tax paid by the casinos on table gaming is entirely commensurate with that of regional-style casinos. On any objective basis, the components, we are paying more than acceptable levels of tax plus then you put the level of commitment on licence fees, which are probably the highest in Australia, plus the additional commitment the company has made to the community support levy, the additional \$3.4 million. On every basis it stacks up as being that the State Government has extracted a very competitive deal, without being so competitive that either we wouldn't agree to it or, by agreeing to it, it would undermine our ability to carry out our affairs to the standard which we do.

**Mr EAKINS** - Just following the line, you are talking about whether the table gaming tax can be taken out. The reality is that, even though the table gaming tax in the casinos has been reduced, the gaming machine tax in the casinos has been increased. From 2013 we will be paying 35 per cent on the revenue generated by the machines in the casinos. So it is the same argument.

**Mr HIDDING** - I guess my real question is: what if table gaming comes back? What is happening in the gaming industry? If you walk into Las Vegas is there table gaming?

**Mr FARRELL** - Table gaming is drifting south. Where isn't it drifting south? It is not drifting south particularly where you have access in all reality to Asian populations. If you walk into the Sydney casino or the Crown Casino in Melbourne you will see very active table gaming. Quite frankly, if you remove the ethnic element from the table for the Chinese, Vietnamese and what have you, you could probably fire a shotgun through the place. Quite frankly, in part what you are saying, Rene, it is a generational thing. A large number of our recurrent punters and people who enjoyed a punt on the tables were post-World War II immigrants. Their children don't necessarily have the same cultural position that they did. Table gaming is suffering the same sort of trend elsewhere. In other countries such as the US it is, in a sense, artificially supplemented by the fact that the croupiers' incomes are supplemented by tips so they are paid a lot lower income. In the Australia casinos, and particularly our own, the croupiers are very well paid; it is a prestigious industry. At the same time, we have continued to try to introduce innovative new products and games over a number of years to try to find ways in which we can stimulate the business. I hope you are right; I hope that it does turn around and the next generation love table gaming.

**Mr HIDDING** - But the next generation is 20 years away.

**Mr FARRELL** - But the tax rate of 10 per cent is still appropriate.

**CHAIR** - Can we move on to term of reference 2. There has been some criticism levelled in submissions to the transparency in the period of negotiation. Does anyone have questions in relation to this issue?

**Mr EAKINS** - Mr Chairman, just before we get to that point, for the record a matter of clarification. Mr Hidding asked about the dates and when this negotiation took place and I was saying April-May. Time slips by very quickly; it was actually earlier than that. It was probably January-February-March, with the agreement being signed in about March.

**Mr HIDDING** - Signed in March and announced in April.

**Mr EAKINS** - That's correct.

**Mr WILKINSON** - I will try to focus on the dot points. There are four dot points provided with the paper, setting out the questions: what was the sequence of events that led to the development of the deed? You have touched on that. Who negotiated the deed; what was the initial position of Federal Hotels at the time the deed commenced - obviously it is bargaining chip, one starts here, another starts here and you discuss and get to an agreement in the middle - and what outcomes did Federal Hotels seek to achieve once negotiation processes had been instigated? They are the areas that I think we want to look at and the first one is the sequence of events, I understand, started January, February March. You are saying it came to you as a result of the Government approaching you first?

**Mr FARRELL** - That's correct, yes.

**Mr WILKINSON** - That was through the Treasurer?

**Mr FARRELL** - That was through the Treasurer's office which then led to meetings between Don Challen and myself, and Andrew and Don Challen with some other Treasury representatives to, in a sense, open a discussion about the Government's desirousness of negotiating to cap the potential growth of gaming machines in Tasmania.

**Mr WILKINSON** - Is it fair to say that the Government were receiving pressures from outside, or would it appear to you that the Government were receiving pressures from outside as a result of maybe problem gambling, and as a result of that they wanted to put a cap on the -

**Mr FARRELL** - I think there is no doubt that the Government saw that there was social and community pressure. I think there is no doubt though that the Government had announced 2003 as the year of its social agenda and there is also no doubt that we had received, not necessarily directly said, but I certainly got the feeling that when I was asked to attend this meeting that what they wanted to discuss was a likelihood of something they may wish to pursue with the company. It then took a number of subsequent meetings between Andrew Eakins and myself and Don Challen and Treasury representatives to start to flesh out whether in fact it was a meeting of minds and quite clearly from my perspective, as I think I have mentioned earlier today, we did not feel it was appropriate for the company to pay additional taxes on licence fees, particularly before 1 January 2009. We also felt that if there was going to be a cap imposed on the

number of gaming machines that number should be an appropriate number to allow the business to manage those outcomes.

**Mr WILKINSON** - You knew what the discussion was going to be before you got there?

**Mr FARRELL** - I had an inkling that that was what we would be talking about. Discussions took some months to progress and in fact were still being concluded really probably up to a week or two weeks before the deed was signed, both in a physical form in negotiations in Hobart and also through negotiations with Mr Challen whilst I was overseas, at some odd hours of morning and evenings as we tried to get some commonsense into it and get to a position where we could both agree.

**CHAIR** - Was Mr Challen heading up the Government's negotiating team?

**Mr FARRELL** - Yes, he was.

**CHAIR** - As Secretary to Treasury or as Gaming Commissioner?

**Mr FARRELL** - As Secretary to Treasury and under my understanding was reporting to the Treasurer. So in a sense he was not only negotiating but also was relaying our position between the parties and was responding on whether or not that was acceptable or unacceptable and we would respond that it was unacceptable and ultimately that was leading to the discussion around what we saw as the pivotal three points. The pivotal three points were that the Government wanted to impose a cap, what would that cap be and then there was significant negotiating about what that number of machines should be. We clearly wanted more than the number that was finally agreed to but we felt that the number that was agreed to did provide us with sufficient flexibility to continue to meet the obligations and the commitment of the existing model.

We clearly wanted to pay less and we clearly wanted a longer licence and slightly different conditions within that licence. Ultimately though we agreed to the additional taxation, particularly those effective from 2003 to 2009, and agreed to the manner in which the licence was constructed in the deed that we signed.

**Mr WILKINSON** - Was there much horse trading?

**Mr FARRELL** - There was a hell of a lot of horse trading, yes.

**Mr WILKINSON** - Was there horse trading from the very, very different proposals that first got on the table?

**Mr FARRELL** - Not necessarily, Jim. I think we very quickly agreed that unless these would be the key components we would be negotiating around. We were wanting to ensure that there weren't going to be any hoary chestnuts thrown in at the last minute to reduce the attractiveness or otherwise of the deal to ourselves and likewise the Government to reduce the attractiveness of the cap and the extra revenue to the State Government. I would have to say that Mr Challen conducted himself at all times very professionally and I would hope that we did as well.

**Mr WILKINSON** - Am I right in saying that what Federal achieved, once being negotiated, in effect was the increase of the licence, the increase of the licence being able to put Federal in a position where they were able to be underwritten, I suppose, by the bank in order to carry out other involvement within Tasmania, which they may not have been able to unless that licence was increased?

**Mr FARRELL** - That's correct. Also, Jim, I think what it also did, and does, is provide the company with the level of imprimatur about its business operations in the State of Tasmania that in fact the business strategy which the company has embarked on is the appropriate one. For instance, an alternative strategy, quite frankly, would be why not invest interstate, why not invest in Victoria, Queensland or other locations in businesses that could well be lower risk than some of the business opportunities we are investing in in Tasmania?

**Mr WILKINSON** - Was that truly an option?

**Mr FARRELL** - It would certainly be an option if the licence that we were operating under had a high degree of risk attached to it because then what you have is all your eggs in one basket, so to speak. So there is no doubt the outcome of this agreement very much fits hand in glove into the way in which the business wishes to and wants to operate in the Tasmanian State environment.

**Mr WILKINSON** - You spoke in your submission - and I quote: 'due to the highly-sensitive commercial issues'. What was so sensitive about it?

**Mr FARRELL** - It was of paramount importance that the negotiations be conducted in a confidential manner. There are many stakeholders involved in this and our view is that negotiations of a commercially sensitive nature should be conducted entirely privately. If the parties ultimately agree to a position, then that position is the public position. Any position prior to having a signed agreement, in our view is tantamount to causing anxiety to and interest by other parties, which would be entirely unacceptable.

**Mr HIDDING** - Competitors?

**Mr FARRELL** - From a community perspective it raises a level of interest which is not necessarily, in my view, justifiable given that in fact that a deal may not have been met. We entered into a negotiation; we might have ended up shaking hands and saying, 'It can't be done. You're too greedy' or 'We're too greedy'. That was, quite frankly, a very likely potential outcome when we sat down, that we were going to meet and agree that this is not something that can be done, which is why I made the opening comments and said that as far as I am concerned, the deal extracted the maximum potential value from the company, it extracted the minimum number of machines under the cap and the minimum length to the existing agreements to make the deal a doable deal for the company and that also met the State Government's requirements.

**Mr WILKINSON** - Did the negotiations ever at any stage lead you to a belief that the negotiations were just breaking down? If they did, where were the negotiations at that stage?

**Mr FARRELL** - I felt that the Government pushed very hard at various times, particularly on issues relating to the number of machines under the cap and particularly on all three pivotal issues. We had significant discussions and negotiations on all three pivotal issues: the length of the licence, the amount of tax and licence fees to be paid, and the numbers of machines in the cap. What we try to do is keep all three of them alive until we are able to get a position which would enable all three to be locked in at once. From a negotiating perspective and from my perspective, to agree to one and have the other two live is a serious negotiating faux pas, so I try to do is keep them live and then when you have them to the door, then lock and execute, and that is what we essentially try to do.

**CHAIR** - Are there any other questions with regard to issue (b) and with reference to the transparency in the negotiation of the deed?

**Mr HIDDING** - I think everybody understands your point of view that conducting the detail of the negotiations in public would be counterproductive to everybody, it would be hopeless. My question goes to what would have happened in 2007-08 as a government of the day was seeking to renegotiate the next tranche of years of this deal? I took it that your organisation would see that as being a totally open process where the Government would announce that, given that the gaming licence deal with Federal Hotels was to expire within 12 months, the Government had therefore commenced a process of renegotiation, submissions and/or points of view being welcomed from any or all stakeholders or all Tasmanians prior to granting another 20 years of this deed. You are now saying that that has not happened in the 30-year history and it was never in your mind that that would happen in this case. Is that the reason that you consider there was no transparency - we don't have to go to the people and give them the opportunity?

**Mr FARRELL** - In a sense there is really a couple of issues. The first one is that in this case the State wished to enter into discussions the seen fact of whether a deal could be constructed. There was every likelihood that deal couldn't be constructed so there is absolutely no point in my putting out a press release saying, 'The Government wants to talk about a theoretical position about an outcome that may or may not be agreed to by parties that may or may not agree to meet' and so -

**Mr HIDDING** - I am not suggesting you needed to do anything. That is not your job to do.

**Mr FARRELL** - So in a sense, from my perspective, the way in which the State agreed to conduct the affairs in confidence was entirely appropriate and I must admit I felt that the manner in which the Treasurer then made a full and frank ministerial statement that covered in depth every key component of the negotiation as well as tabling a copy of the deed in the act in the Chamber was an entirely appropriate way for the State to act.

**Mr HIDDING** - It was part of the legislation factor, the deed.

**Mr FARRELL** - Yes, but it was the way in which the Treasurer made a full and frank admission of all key components was a job well done.

**Mr WILKINSON** - I am asking the question - I think I know what the answer is, but I will ask it anyway. Is there anything in the negotiations that were conducted and the

agreement that was reached that you believe that we, as a committee, should know about that as yet has not been spoken about?

**Mr FARRELL** - No. To the best of my knowledge there are no additional components or elements of the deed or agreement that are not in the public domain.

**Mr WILKINSON** - Because in five or six years' time, if there is, if somebody comes back and says 'This was never made known' we could appear to be foolish and your side of the table also could appear to be foolish. That is why I am asking now whether there is anything that you believe we should know about at this stage that has not been canvassed?

**Mr FARRELL** - Not to the best of my knowledge, Jim, no - nothing whatsoever.

**Mr HIDDING** - I have one more question on the whole thing.

**CHAIR** - Is it in relation to this term of reference?

**Mr HIDDING** - No, I will leave it until later.

**CHAIR** - If there are no other questions in relation to terms of reference (a), (b), (c) and (d), I intend to move on to the more general area of questioning in relation to other issues relevant to the deed, which is the last term of reference. Does anybody have a question in relation to that? I have a number of questions to ask but others may wish to go first.

**Mr HIDDING** - Could I just ask about the Coles Bay deal. In July 2002 you announced the development there of 150 rooms - and that is great news. You have said in your submission to us and you have said here today that your financiers have the comfort of knowing financial arrangements are in place in another sector of your business for the next 20 years. The Government is - and I guess you are as well - holding this development up as being one of the benefits of the State agreeing to this new deed. Are you saying that if the Legislative Council does not agree to the legislation before them now that Coles Bay will not be built?

**Mr FARRELL** - No. What I am saying is that this agreement allows for the development of a defining world-class resort at Coles Bay, which, in my view, will help position Tasmanian tourism at an international level. Without the confidence of our business going forward, which is very much aligned to the agreement that is before the House, we will still built a very good quality hotel that will be lovely for tens of thousands of people to stay in over many years, however we would not have the financial wherewithal to commit to a defining world-class Tasmanian iconic resort which I believe that location requires. I believe it will help support the positioning of the Tasmanian tourist industry to where it should be. What we are talking about here is not a threat about not doing something; what we are talking about here is that the new licence will provide us with the financial commitment of our financiers and the internal commitment of our directors to fulfil a vision for our company and I truly believe for the State of Tasmania.

**Mr HIDDING** - From that statement, then, there is a degree of commercial cross-subsidisation, even if it is giving confidence to the rest of it.

**Mr FARRELL** - I call it 'nerve'. Our business success is very much about holding our nerve. For example, with the establishment of our very successful transport business that operates right around Australia, we had to hold our nerve with that business for four or five years in an environment where many others may have folded. We held our nerve and we now have, in our view, an extraordinarily successful operation that operates Australia-wide.

**Mr HIDDING** - What's that one?

**Mr FARRELL** - COPE Transport. Holding your nerve in my view is that you set out with the strategy, you have done the research and got your business case and then you have to hold your nerve until such times as you can make it happen. The only way you can hold your nerve in all reality is you need to be able to tighten your belt and you need to have deep enough pockets. There is no absolutely no doubt in our view that Tasmania can achieve a world-class five-star product of international scale. Do you have to hold your nerve to get there? Absolutely. Can we do it? Absolutely.

**Mr HIDDING** - You are going at price points between 250 and 500, that kind of price point - it is a whole new market -

**Mr FARRELL** - We have to generate a whole new market for Tasmania in part to do that.

**Mr HIDDING** - If the market after five years or so didn't happen, is there a possibility you would come to the government of the day and say, 'How about a third casino licence on that site. Seeing we built this world-class facility, can we put in a small gaming room?'

**Mr FARRELL** - Is there a possibility of doing that? I would say, at this point in time, it is highly remote. But being in business for a long period of time, you rarely ever say 'never', but, at the same time, it is not being built to do that. In fact, we have publicly stated that it will not have a gaming machine.

**Mr HIDDING** - What, you don't like them much?

**CHAIR** - Let's keep it focussed. I have a couple of questions. Can I conclude that if properly managed in a suitable site gaming machines provide a competitive advantage to the licence holder? Is that a fair statement?

**Mr FARRELL** - No. Gaming machines by themselves obviously create nothing. So, in a sense, what you need is a number of ingredients. You need to have a venue that is located in a vicinity where it is going to be attractive to people -

**CHAIR** - I've gathered up suitable sites so that -

**Mr FARRELL** - you need to have a suitable level of management that is going to be committed to the promises. You are going to have to have a level of capital expenditure investment in that business to position it as attractive to patrons. You are also going to have to support it, in the majority of cases, with a very good food and beverage product, entertainment, good lighting, a successful advertising campaign. There is a whole series of objectives required to support the difference between a venue that may be successful as gaming and one that is not.

**CHAIR** - I tried to gather all that up under management, if I understand all those things you're saying. That to me means that if you put them in and don't do anything about them or manage them poorly and don't set the ambience right then you are going to fail.

**Mr FARRELL** - Or your hotel is the wrong design. We have many instances where the positioning of a door or an access is the difference potentially between success and failure.

**CHAIR** - Yes. But I go back to my original statement, that if properly managed and all the ambience is right, in a suitable site which gathers up logistical, movement and siting matters, then they are a competitive advantage?

**Mr FARRELL** - Well, they can be; it is not to say that they are. You can use as many analogies as you wish to say that this potentially is a great venue and has all the right things going for it, but gaming won't work for it, and then it is no advantage to anyone. In fact, it can be more advantage not to have them, as probably a number of hotels have very successfully demonstrated throughout the State.

**CHAIR** - But your team and others make judgments about that and, whilst they are not always correct judgments, the majority of cases would suggest that they are the correct judgments and that gaming machines are a competitive advantage.

**Mr FARRELL** - In a number of venues where they have made judgments that gaming machines would be a successful product, yes. At the moment we have some 150 venues in the State that have keno and we have 105 venues in the State that have gaming machines.

**CHAIR** - The concern I have is that, I guess, Network Gaming makes decisions with regard whether they will or will not provide gaming machines to a particular site. As you have mentioned earlier in your evidence, that may be on the basis that by putting machines into a site will impact negatively on other sites in reasonable proximity or it will have community-negative values. That is an awesome responsibility; if your strike rate at picking good sites is correct and high percentage and it gives a competitive advantage, then you're making judgments in not giving this party a site that he is going to fail because they can't match the competitive advantage of near neighbours.

**Mr FARRELL** - I don't think that is necessarily a correct assumption to draw. There are many instances where you will have very successful venues that don't have gaming machines, that might have an outstanding food and beverage product, a charismatic host, great live music that will operate in the same vicinity of a gaming venue and it will be a highly successful business. So the gaming machines don't determine whether a venue is going to be successful or unsuccessful.

**CHAIR** - You have a process - and I guess it is very clear and laid down by your Network Gaming manager - about how you make those assessments. If a person feels aggrieved about a refusal, does that party have any appeal rights? How would an aggrieved party get some natural justice in relation to the matter?



**Mr FARRELL** - I think, in the first instance, that aggrieved party would make further representations to Network Gaming and Network Gaming would then have to review the circumstances in which it made its decision and go back to that party to say whether in fact it was felt appropriately or otherwise about the decision. In some instances Network Gaming will ask that venue to re-present itself in a further 12 months, after a further 12 months of ascertaining what circumstances may have changed. I think, furthermore, over the last number of years the industry is represented by major associations apart from Network Gaming, so in this case you have the Australian Hotel Association, Tasmania Branch - an extremely well-connected, well-organised, professional organisation - and you also have Clubs Tasmania. In the event then that Network Gaming had operated in a way which was seen to be against the interest of the members of the AHA, the company would have had substantial representations by those organisations. In all reality, over all the years that I have been involved in this business, I would have to say that that is not the case. In reality the organisations that the majority of hotels, particularly the professional, well-managed hotels, are members of have a representative body that would seek representation with Network Gaming over what could be considered less than appropriate behaviour or attitude towards one of their members. But that is not the fact; in fact the AHA actually has a subcommittee which deals with gaming matters.

**CHAIR** - But, in effect, a party has no appeal other than to Caesar?

**Mr FARRELL** - Yes, as is the case then in many other commercial operations, such as the TOTE. In our view it is entirely appropriate and as this bill before the House has become known, we are now seeing parties clearly positioning themselves publicly saying they want gaming machines and we won't give them to them. I guess, in a sense, that underwrites one of the earlier discussion points we made: if we gave gaming machines to every party in the State that wanted gaming machines, quite frankly we wouldn't have 105 venues in the States; we would have in excess of probably the number that currently have keno, which is 150.

In a sense, what we have tried to do is be responsible, not only to the community but also to the venues. One of the things that Network Gaming, I believe, has done to a very high degree is to say to venues that want to have gaming and can, in our view, demonstrate that they are a fit and proper business and a fit and proper person to the Gaming Commission, that in the majority of cases they have to commit substantial levels of investment to prepare their business for that opportunity. In our view then, Network Gaming has a very clear obligation to the very best of its ability to assess that that venue will be successful. In many cases we are asking venues to re-equip, paint, better training, better food and beverage facilities, better parking, to position themselves as being a good reflection of our business model. They are given an obligation; if they prepared themselves for this then they will be given a level of gaming machines but we can't give them an obligation that they will be successful. So if they are not successful and those machines are subsequently removed, then those people have made a significant investment in the business opportunity that is now not successful.

**CHAIR** - But we have a scenario where the only appeal is to Caesar and yet you, Network Gaming and Federal Hotels, have licensed hotels strategically placed around the State - not a great number but you have five or six hotels which are licensed to operate gaming machines. Doesn't that provide you with an unfair advantage within a community? You have said that if you get it right, if all the factors are right, then there is a competitive

advantage in owning them. If Federal Hotels can't get it right in their own hotels something is wrong, so we presume that there is a competitive advantage, yet the next-door neighbour has no right of appeal other than to Network Gaming.

**Mr FARRELL** - If we go back a step and say that the Federal group made a decision some four plus years ago that it would be a viable business for Federal Hotels to be involved in, not only to supply gaming products to hotels but also only hotels that had gaming.

We then entered into discussions with industry on the basis that this is our intention to do this because obviously there were some concerns. The concerns were, 'Surely, you've got a stand-up start into being in a position where you could be seen to be using the system to your advantage'. We made it very clear then, although there is no legal obligation for the company to have done this, that the company would not buy a hotel that did not have gaming machines, though we could, that was ideally situated to have gaming machines - this is over the last five years - apply to ourselves through Network Gaming with a fool-proof business case, which I am sure that we could do, Network Gaming, quite frankly, would then look at it and say, 'This is a damned good opportunity for gaming. It's a wonderful business case - committed management - we'll provide gaming machines to that venue'. That would have been a very good way, quite frankly, for this business to have been able to create wealth but at the same time though it would have created, in our view, very clearly a very strong perception, 'Well, you're helping yourself to the cookie jar' or whatever analogy you wish to use. So we said we wouldn't do that. We said that if we want to operate gaming machines in licensed hotels we would stand in the market and buy that hotel and we would operate that hotel then as a hotel that already had gaming machines and which is in fact what we have done.

Then if you look at where have we got these hotels, if you look in Hobart we operate the Claremont Hotel which is in fact the last hotel with gaming machines in a long line of gaming machine hotels, totally surrounded by a competitive product. We also operate the Waterfront Hotel at Bellerive and, again, in very close vicinity to a significant level of competition from gaming product. We also operate the Hotel Tasmania at Launceston in the middle of town and it is very much open to a large amount of competition and we operate the Hotel Federal in Wynyard which again is a very small regional town. That hotel had gaming machines prior to the acquisition by Federal. It was a successful venue with gaming machines prior to being purchased by Federal and remains a successful venue with gaming machines after significant capital investment in improving its food and beverage services and it is now in fact, I think, a first-class cafe-style restaurant as well as being a first-class gaming venue.

**CHAIR** - Okay. In 1994, Victoria changed its act to provide that an operator couldn't hold such licences. Why shouldn't that be the case in Tasmania?

**Mr FARRELL** - I can see no reason why Tasmania would just need to adopt what has been passed in other States for any sort of legislation unless there was a fit and proper reason for it to wish to do so, and in this case we would have to say again that there has been no view that is known to me about any significant view by industry that our businesses operate in any way in an inappropriate way in relation to the management of gaming venues. The business that operates gaming machines in licensed hotels is a distinct entity called the Vantage Group. Its general manager is Peter Grubb. It is a distinct different

business entity to Network Gaming managed by John Mortensen. The only common link between the two of them is that they are ultimately owned by the same parent company.

**CHAIR** - As with the capping procedure and this procedure, it is a policy of your organisation that to be a good corporate citizen, to be socially responsible, you take a certain course of action; you don't acquire hotels unless you stand in the market. That policy could change in the future, couldn't it? Another managing director at another time, in a decade's time, could make a decision, 'What we're really about is bottom line here and we've got to get out and acquire all the hotels and put our gaming machines as licences become available, transfer them to our hotels that capture the market'. That is a scenario, that is a hypothetical but it could happen.

**Mr FARRELL** - But in a sense, say, the company has made a commitment to the hotel industry that it wouldn't do that. For the company, whether it was me or someone else, to subsequently breach that commitment - well, from my perspective I am saying that wouldn't happen. It wouldn't be done.

**CHAIR** - Yes, and I accept that totally, but I am saying what if sometime in the future there wasn't a Greg Farrell who was a good corporate citizen, socially responsible, sitting in your chair and decided to follow a different path? There would be no reason why that person couldn't.

**Mr FARRELL** - However, there is every reason to suggest that the industry reaction would be pretty torrid for that particular person.

**CHAIR** - But what could the industry do about it?

**Mr FARRELL** - Business, as you well know, is based on maintaining, in our view, long-term sustainable, successful relationships and is about creating complementary outcomes. By and large, businesses that rip off their customers or their suppliers, or the Government or whatever may well reap benefits in the short term but it rarely ever will be successful in the long term. Our whole business modus operandi is to be a sustainable, successful business.

**CHAIR** - You have referred in your submission to impacts upon sovereign risk and the Government taking that course of action that would cause you pain and would be a breach of the concept of sovereign risk. I think it suitably can be brought into this debate as another issue but the Government has a power under section 127 of the act to give instructions to the Gaming Commissioner; the Gaming Commissioner could be instructed by government to take a certain course of action with regard the granting of future licences. Would you see that as being an attack on the sovereign risk potential?

**Mr FARRELL** - From our perspective the issue of sovereign risk is that in 1993 we entered into an act and a deed that set out the obligations of the parties, which was to run to 1 January 2009 unless, as Rene was saying, we renegotiate prior to that. From our perspective - and it is clearly dealt with by the recent Legislative Council select committee's inquiry into gaming - every obligation entered into by Federal Hotels has been met or exceeded, every obligation entered into by the State Government has been met and exceeded. In our view, those undertakings led to the company committing significant investments in the State of Tasmania, making significant obligations to the

State; all of those have been complied with. For a State government then to rule that the terms and conditions of that agreement should be set aside and a new position imposed on them for some other reason we believe would be a totally unsatisfactory outcome and one which would not only cause this company to wish to seek some compensation for what it would have seen as being wrongly removed from it but also would undermine the confidence of any other potential company wishing to invest in Tasmania seeking agreements through legislation or deeds with the State Government. To my mind it is as simple as that.

**CHAIR** - If the Government should issue a public, open, transparent statement to the Gaming Commissioner not to issue a licence to a Federal Hotels-related business to trade in Smithton at a given time in the future and that was an open transparent process, would you see that as an impact on sovereign risk, as undermining the sovereign risk?

**Mr FARRELL** - Yes. Back in 1993 this particular issue was discussed, which was the issue of could Federal Hotels conduct gaming-related affairs in venues that it supplied gaming product to. I clearly remember thrashing out in the wee hours of one morning as to why that would be a right that we would not deny ourselves in the negotiation. At that time we had no necessary interest in introducing or owning gaming venues. It wasn't until four or five years after that, probably six years after that, that we developed a business option of acquiring licensed gaming venues in the manner that I earlier commented on. In my view, it was one of the tenets of the 1993 negotiations.

**Mr WILKINSON** - In relation to that, one may argue that you have acquired the licence for the gaming hotel because you own a number of them and you are able to - and I suppose this goes to any business at all - reduce your accommodation prices, reduce your food prices in order to get people into that hotel as opposed to anywhere else. Do you think that is a proposition?

**Mr FARRELL** - I think you could run that case if that were true but it is not. If you look at the way in which we operate our businesses, none of our businesses are operated in a way which could be said to be cannibalising other businesses. It is true to say that at the Hotel Tasmania we have \$4.50 roasts and we serve some thousands of people a week. It is also true to say that that business makes money on its food and we use very affordable and extended hours of dining in that restaurant as one of the key competitive reasons why that hotel is so successful. Do we do that because we can afford to do it? No, we do that because for that hotel it is a key success factor and the fact is we can make money in the way in which the kitchen is set up and based on the volume of meals at a lower break-even point than we can at the Country Club.

**Mr WILKINSON** - Gaming in relation to your hotels - Oasis run the gaming, is that right?

**Mr FARRELL** - Rather than do what you have seen in Victoria or New South Wales where there are Tatts pokies or Tab pokies or Tabarets, we took the view in the very early piece that we would market gaming, whether it was gaming machines or keno, under the brand name of Oasis with no mention of gaming. The reason for that was that we wanted the word 'Oasis' to stand for a quality entertainment venue that included good food and beverage, good lighting, professional management and would also include a gaming opportunity, which might be keno, it might be gaming machines or it might be both. We

steered right away from trying to position venues with gaming machines as gaming venues because gaming is only one component of a successful business.

**Mr WILKINSON** - I have noticed - and perhaps I am wrong - that there has been more advertising in recent times coming out of your local Oasis - play gaming machines or whatever it might be. I don't whether that is right.

**Mr FARRELL** - I don't know. We certainly run advertising campaigns throughout the year in support of the venues but I think you have to consider that the advertising for Oasis is about quality, fun entertainment venues; it is not about 'Come here and play the pokies'. We are seeking to achieve a situation that when you are driving through regional Tasmania and you see the sign 'Oasis' you will know that if you stop at that pub you are going to get good service, it is going to be clean, the toilets are going to clean, it is going to be well managed, it is going to have a gaming opportunity, it is going to have good food and beverage. This sets up a higher level of expectation and it is also to make the hotels, by and large where possible, more family friendly. I think really Oasis, as a concept, has been highly successful in helping to reposition the hotel industry from where it was five or six years ago where, quite frankly, many people would have said it was really an industry in decline. Now Tasmania has a vibrant, healthy hotel industry - both those associated with gaming and many venues without gaming have been able to position themselves as outstanding food and beverage or entertainment centres.

**CHAIR** - Are there further questions in relation to this or any other matter?

**Mr HIDDING** - We have received a number of submissions and I don't think it will be possible for every single one of these people to come in and speak to their submissions. I want to make sure that I can actually tell these people that we will ask questions on their behalf so that they don't have to come in here and go through this. There is one particular point that is a bit of a common thread through all this from some stakeholders and this is the monopoly situation. These things happen in a small State from time to time, it is just one of those things. I offered you the opportunity to comment on the problem flowing from earlier questions about you targeting, for example, the owner of quite a decent hotel in Tasmania who feels that he or she wants to develop into network gaming, puts up a proposition to you and gets knocked back. The knock back says, 'Oh well, we've got an outlet there and one there and they're doing very nicely and there's no room for you'. In their submission to you they have to disclose everything about their business; you then have at your fingertips the cards up on their business. What is to stop you from later acquiring that business, applying to the Gaming Commission and putting machines in there?

**Mr FARRELL** - As I commented earlier to Tony, we have a policy that we will not do that. We will not acquire a business that doesn't have gaming machines and put gaming machines in it. We could have done that, we could that, but we will not do that. I made that commitment five years ago.

**Mr HIDDING** - Why doesn't the deed say that?

**Mr FARRELL** - Because the deed allows us to do it, which is -

**Mr HIDDING** - The new deed, the proposed deed?

**Mr FARRELL** - It's never been an issue. The industry knows and I know that we will not do that. We may well acquire further hotels in Tasmania that have gaming machines and if we do that we will stand in the market. In fact there are hotels in this State that I would like to have acquired and have not been able to because the value equation was not appropriate.

**Mr HIDDING** - How many hotels would you like to own?

**Mr FARRELL** - Another one or two - I won't tell you which ones. Why do we want to do that?

**CHAIR** - We can go in camera to take any of that commercial-in-confidence information.

*Laughter.*

**Mr FARRELL** - I would say the reason we want to do that is that we have certain levels of overheads in that business that could be successfully applied over one or two venues. It couldn't be much more than that because then we would have to put more overheads in and it changes the equation again. It is a business and we certainly like our business.

**Mr STURGES** - I just want to follow on from that line of questioning but get away from the acquisition issue of Federal buying into pubs. It does take into account some issues raised in submissions that the committee has received. We have pretty well dealt with it so I don't want to flog it to death but I want to come back and revisit this issue of Network Gaming licensing hotels, though I will include the clubs because I think it could be relevant into the future, again taking into account the submissions that we have. Network Gaming makes the assessment based on the processes that have been gone through before and determines that pub A and club B are worthy of licence but, given the cap in the new deed, there are no more pokies. You have indicated that you think 105 or 110 venues is about right in Tasmania. We have a new licensee of a pub in a town that has been assessed as being worthy of a licence and is very keen to get hold of those pokies. What process in the future does that particular businessperson have open to them to get access to those pokies? Do you, for example, have a look at non-performing pubs and clubs and then reallocate and redistribute?

**Mr FARRELL** - Really, a person who wants to get into gaming in the future after there is total absorption of the existing product, 3 680 machines in the market, could do one of two things: they could do what I would do, they could stand in the market and compete. If there was a venue for sale that had gaming machines and I thought it was fair value, they could buy it. That is one option and it is a pretty good option. The second option is that Network Gaming needs to continually manage the markets, so they work with poor performing venues - that is, venues that have low revenue per gaming machine. Quite frankly, you are able to operate gaming machines and lose money. If a venue is losing money or is at marginal, Network Gaming commit a great deal of time and energy working with that venue to try to improve its performance. If that venue, say, had 20 machines, they would reduce the machines in that venue because obviously it is oversupplied. If they get down to 10 machines and that venue still can't perform to an adequate level then the machines will be removed.

**Mr STURGES** - So you have a minimum as well as the maximum?

**Mr FARRELL** - Yes. We believe that if a venue can't perform adequately with 10 gaming machines then it shouldn't be in the business. Those machines would then be available for reallocation throughout the network. If new venue or an existing venue had 15 machines but was undermachined for whatever reason, Network Gaming would be able to draw on its supply to allocate  $x$  number of units to that venue. The 3 680 or 2 500 cap on gaming machines in the network is a total cap but that cap then is managed between the maximum of 30 at a hotel and 40 at a club. Between that there will be various levels of movement based on performance between the number of venues within the network - and there will be few opportunities for it - and venues that don't have gaming machines will be granted gaming machines in the future. There will continually be this balancing and refining act over the next 20 years.

**CHAIR** - Are there any other questions members would like to ask? Mr Farrell, Mr Blomeley and Mr Eakins, I thank you for your attendance at the committee. It has been helpful to have you appear and we will be considering and reporting in due course.

**THE WITNESSES WITHDREW.**

**Mr DON CHALLEN**, SECRETARY, DEPARTMENT OF TREASURY AND FINANCE, WAS CALLED, MADE THE STATUTORY DECLARATION AND WAS EXAMINED.

**CHAIR** (Mr Fletcher) - Obviously, Mr Challen, you are aware of the terms of reference that we have. There are some limitations in relation to that with regard your role as Gaming Commissioner and it is not our intention to go into that field unless at a later stage it is considered to be worthwhile and then we will discuss that with you to check the parameter in regard those matters. But we have a particular interest in your position as chief negotiator, as we understand, for the deed between the Government and Federal Hotels. We have taken evidence from Federal Hotels at an earlier stage today and we would like to discuss aspects of that and question you in relation to that program.

We have five different terms of reference. I think there is a general correlation between terms of reference No. 1 and No. 3, No. 1 being the return to taxpayers and No. 3 being the quality of the deal extracted by the Government, so they will tend to run over to one another. We will to the extent possible try to have a logic about our questions, keeping them to the terms of reference. The question I have for you, do you wish to make any opening statement or are you happy to proceed with the questioning?

**Mr CHALLEN** - No, I think perhaps by way of explanation, Mr Chairman, clearly I wear two hats today but the reason that I encouraged the secretary of the committee to call me as secretary of the department is that the Gaming Commission had no role whatever in the negotiations or the arrangements and I carried out the negotiations with some colleagues on behalf of the Government. There may be issues that the committee is interested in that I can help you with in my capacity as Chairman of the Gaming Commission. I am more than happy to do that but I think it is important that you understand the commission, as such, had no role in these negotiations.

**CHAIR** - Yes, I think we all agree with that. There are a couple of questions I would like clarified personally in relation to the Gaming Commission but we will leave them to last if that suits you okay.

**Mr CHALLEN** - I am happy to assist in any way I can.

**CHAIR** - Mr Hidding, do you have any lead-off questions you would like to ask of Mr Challen.

**Mr HIDDING** - I guess my first question flows from this morning where it became apparent in our questions of the Federal Group this morning that they are of the opinion that their deed, the current deed, is simply an extension of previous deeds over the last 30 years and is not a contract that ought be tested against the marketplace with a view to somebody else, for instance, getting the licence to do network gaming in their place. They do however refer to competition throughout their document and it appears that they believe the only valid competition possible would be another player, in spite of the fact that would unleash another few thousand machines, and I have never heard anyone actually promote that. If nobody is promoting another player, and we are not and I have never seen the Government do that, and they believe that there is no competition as such



for the right to run gaming machines in pubs and clubs, do Federal Hotels not in fact have these licences for life?

**Mr CHALLEN** - Legally they don't. I don't think there is any legal question that their present licence will terminate on 30 December 2008 if it is not renewed and were nothing to happen before that date they would not have a business. That is the legal position. But in terms of the way the current Government and previous governments have approached these matters, this was obviously an issue that we considered in our approach to the negotiations with Federal Hotels, when you have an incumbent operator that has been operating under various forms of licences for 30-odd years and there is a view on the part of governments and I think it would be shared broadly in the community that this operator has fulfilled their obligations under various licences and agreements, that they are a good corporate citizen, that they are reinvesting their profits into the Tasmanian economy, I ask you whether it would be real life to allow those licences just to come to an end and wave them goodbye.

I think the issue is while the legal position is very clear and that gives the Government's officers a fair bit of leverage in negotiations, it is probably not real life realistic to think that you could just terminate those licences and wave them goodbye, but it is a theoretical possibility.

**Mr HIDDING** - The leverage that you are talking about in negotiations, a real life possibility is that it could come to an end so there is real leverage there.

**Mr CHALLEN** - Yes.

**Mr HIDDING** - It would appear from their responses this morning that they see that as not a real life thing and you don't see it as a real life thing. How were the negotiations then in any way commercial negotiations? If both negotiators know that there is no possibility of, for instance, Tabcorp Victoria actually competing for the network gaming business -

**Mr CHALLEN** - I think you have stretched what I said a moment ago a bit beyond what I wanted to say. It is like the contestability of markets, it is the fear, if you like, of the possibility that someone else could come in that keeps them honest. I did say to Mr Farrell across the negotiating table a number of times that 'Come 1 January 2009 you don't have a business'. I put a reasonableness test on the outcomes we get from the negotiations and if I didn't think they were reasonable in the interests of the Tasmanian community I would have kept pushing Mr Farrell until I got him to the point where I thought we had a reasonable outcome. In the back of his head he knows that legal possibility of the licence coming to an end is there and that is a discipline on him to come to the negotiations with a realistic attitude. So I think they are truly commercial negotiations in the way that many negotiations go in the commercial world where both parties really want to do the deal but both of them know that if they are not sensible the deal might not occur.

**Mr HIDDING** - We are talking here about a pair of licences that grant the ability for an organisation to produce a gross profit of over \$1 billion over the period of the contract. I think it is in the order of that -

**Mr CHALLEN** - I don't know, I haven't done that sum.

**Mr HIDDING** - In the order of \$1 billion. Last week there was a block of land sold at Kingston Beach. Prior to its selling the real estate agent thought it might be  $x$ , someone else in the real estate agency thought it might be  $x$  plus 2, the owner thought it might be  $x$  times three and it went to the market and they got  $y$  times 5 - they got \$347 000 for a block of land. The only way you could actually determine the value of that price of land was to put it to the market. I put it to you that, all other things being equal, considering they have been a terrific operator - there is no question, a great operator - how can the Tasmanian people have confidence in knowing that the dollar value extracted for them - and it is the prime licence of our public licences available - was the right amount?

**Mr CHALLEN** - I think that is a fair question. We prepared ourselves for the negotiations against a background of some policy direction that we were given from government and from information that is in our hands we were able to construct a model of Federal Hotels' business. Internally and in discussion with the Treasurer we formed the view about what it was reasonable for us to attempt to extract from those negotiations and that gave us a target that we were trying to achieve. In the end, I felt comfortable that relative to what we might have achieved the outcome was quite acceptable given that I was given some riding instructions from the outset.

I think it is also important to understand and no doubt when the Treasurer meets you he will be able to expand on this in more detail, but it is important that the Government went into these negotiations wanting to get something from them, so the starting point of my instructions from the Treasurer was that he wanted to achieve a cap on the statewide number of gaming machines. That meant that the timing of these negotiations was essentially initiated by the Government and, to a degree, that constrained outcomes. In terms of the dollars that are being returned to the community through the agreement that has been signed with Federal Hotels, I think the outcome is quite acceptable. The only alternative to doing the modelling and applying the reasonableness test is to actually go to the market so you would have had to have let the current agreement run near to conclusion, say, a year or 18 months before it ended, you go out to expressions of interest, you see what people are prepared to bid and you have a Basslink-style competitive tension bidding. It is a traditional model that we are all very familiar with, but for a number of reasons the Government didn't wish to go down that route so we came at the negotiations in another way. It's not uncommon for us to find ourselves in those positions. You often effectively have to negotiate when there is only one truly interested party on the other side. You have to construct a framework within which to think your negotiations through that allows you to apply reasonable tests when there is no market test.

**Mr HIDDING** - Were you encouraged to not construct a full commercial model as to what you might get in the market because you had been given a policy position? After all, that was the Government's position in order to deliver a cap.

**Mr CHALLEN** - I will have to ask you to respect the process by which I gave policy advice to the Government and the policy decision that was made. It would be obvious to you that I was involved in those debates. By way of preparation to all this, advice was prepared for government, there was a debate between the Treasurer, my colleagues and me about what sorts of models were workable and then the Government made some policy decisions which formed, if you like, the framework for the negotiations that I had

to conduct. The important thing was that the Treasurer set an objective of a statewide cap on the number of machines and was willing to entertain an extension of Federal Hotel's licence because he knew he would have to be to get what he wanted. He instructed us to ensure that we conducted the negotiations in such a way that, in terms of the financial outcomes of the deal, we would get a good outcome for the community. We had to satisfy him at the closing stages of the negotiations that we had achieved those objectives.

**Mr HIDDING** - I know that somewhere - you may not have it in your mind - there will be a figure that you could express for the Government to consider the value of its policy position, the social value of putting on a cap as opposed to the raw market model of going to the market and getting full value for your prime block of land. What was the financial cost of that policy position?

**Mr CHALLEN** - I haven't quantified it in the rigorous terms that you asked the question and in fact I came at the issue from the opposite direction. The way I came at it was to consider the hypothetical in which on 1 January 2009 Federal Hotels has no business and we are talking about circumstances in which they are looking for a renewal of their licence on non-exclusive terms. I must admit, given the policy direction I had, I did not approach this from a clean sheet of paper approach in which Federal Hotels would just be forced to abandon their business. The assumption always was that they would be able to continue their business but perhaps in competition with someone else or having to bid for the continued right against somebody else. We modelled what their business would look like under the status quo and we modelled what their business would look like if they had competitors in the market. The difference between the two gave us a rough order of magnitude of what the continuation of the status quo was worth to Federal Hotels and we used that as a benchmark for our negotiations. My objective was to try to take out at least 50 per cent of that difference in terms of improved financial return to the community, and I got fairly close to that.

**CHAIR** - Mr Challen, could I ask a couple of questions in relation to the cap? Was that the most important driver leading to the negotiations between government and Federal Hotels?

**Mr CHALLEN** - Yes.

**CHAIR** - Given that you have previously on the record stated that you believe the marketplace is in balance, that there is very little opportunity to further expand the number of gaming machines in the marketplace, did you ever advise government that that wasn't a significant matter that ought to be of primary consideration?

**Mr CHALLEN** - I will have to ask you to protect the process by which I give advice to government but my earlier evidence to Mrs Smith's committee has been slightly misinterpreted. I spoke of the market being mature; you spoke a moment ago of its being in balance and this issue you will recall came up at the Legislative Council Estimates committee meeting and someone there encouraged me to say something similar. What I meant by those remarks - and I clarified them at length at the Estimates committee hearing - was that the rapid rate of growth of turnover has disappeared from the market so as new venues come on stream and additional machines go into existing and new venues in the market so the turnover is increasing but the rate at which the turnover is

increasing is beginning to slow. And if you look at the statistics on the gross profit per machine per day you will see that it is not increasing any more, it is reasonably stable.

What that means is that there is still an incentive on the part of the operator to put more machines into the market because the capital investment that is going into each machine is still producing an increase in the absolute level of returns but the rate at which that absolute level of returns is improving is beginning to soften. What that tells you is that somewhere out there in the future there will be a point at which the additional capital from the marginal machine is not worthwhile anymore, that the return you get doesn't warrant the investment in additional machines. We don't know where that is but it is certainly significantly above the number of machines that are in the marketplace at the moment. That is the sense in which I meant the market is maturing.

**CHAIR** - It has been suggested to us at an earlier time that the current business model of Federal Hotels recognises that if the market is not in balance now it is not far in balance taking out all the extraneous matters that might emerge in the future and it would take a change to their business model to really drive a further rollout of machines, that there could be a lot more venues there wanting machines but that would be a socially irresponsible thing to do and it wouldn't necessarily lead to a big increase in their revenue stream or their bottom line. Do you agree that that is the situation?

**Mr CHALLEN** - Well, I don't know whether I can agree or disagree, Mr Chairman. I think it is an issue about the way Federal Hotels have approached the market. They haven't been very aggressive in signing up particularly marginal venues and they haven't pushed very hard to the limits of machines in individual venues. Whether it can or not in the future is a matter of conjecture but I think it is pretty clear that, particularly over the early years of the rollout of gaming machines outside the two casinos, the market would have borne many, many more machines than were put out there. Federal Hotels have made a decision, no doubt in part constrained by some business issues, such as their availability of capital and so on and no doubt by responses to community issues that the community didn't want to see hotels and clubs flooded with gaming machines, they have developed a fairly non-aggressive business model. They could have done things differently.

**CHAIR** - Yes, they have been good corporate citizens and they have acted responsibly.

**Mr CHALLEN** - I think they have. Mr Farrell said to me across the negotiating table a couple of times that if they were not confident that their licence was going to continue beyond the end of the current licence period then their business model would be different. They presumably would have been a great deal more aggressive in putting machines out there preparing themselves for a competitor, for instance.

**CHAIR** - Having agreed that they are good corporate citizens and are acting responsibly, would it be necessary for them to be bad corporate citizens and to act irresponsibly to roll out a heap more machines?

**Mr CHALLEN** - I don't think that follows, no. It is a question of the balances they make between their desire to protect their business on the one hand and the community's perception of them on the other. If you create an attitude on the part of the committee that is hostile to your business, your business won't be financially successful. Good corporate citizenship is not entirely altruistic.

**Mr STURGES** - The chairman did say that that points 1 and 3 of the terms of reference are somewhat linked and I will go down the track of the taxpayers and the overall quality of the deal. There are three basic points: the cap, the tax and the length of the licence. I think they are the three issues that are all intrinsically linked around this deed. You have spoken about the caps and I don't want to go there. In regard to the new deed, the return to taxpayers and the quality of the deal, could you give us your opinion regarding the tax. You have touched on the length of the licence in relation to Federal's requirement for the knowledge that they will be able to operate their business with a degree of stability into the future, so maybe the tax is an issue that I would like to hear a bit about.

**Mr CHALLEN** - The existing tax rates we have felt were always reasonably appropriate for the style of business and the style of market. Obviously you can do some comparisons with tax rates in other jurisdictions. I think you have to be a little careful with tax returns because in some jurisdictions there is an up-front licence fee payment that is made and that was an option that was considered in this case. The consensus was - and I think this was as much Federal Hotels' preference as it was our preference - that it is better to have a flow of revenue that is fairly even over time than a burst of revenue in one year at the beginning of a new licence and then a smaller flow of revenue over time, so that balance was made. We also had to make the balance between the fixed components - the licence fee payments - and the parts that depend on activity turnover. The existing tax rates were really the starting point, so in negotiating taxes and licence fees I was in the main trying to extract as much as I could of that benefit that Federal Hotels would get from a continuation of an exclusive licence, as opposed to being in competition with others. The particular package that we came up with was really designed to do that and to produce sensible incentives for Federal Hotels in terms of the different parts of their business and the way they promoted them.

For instance, there has been some negative public comment about the reduction in the tax rate on table gaming. That was fairly deliberate on our part. We had got to a particular point in the negotiations and were looking at tax rate options. The tax rate that we liked the best, because of its elegance and tidiness, actually overcooked the return a bit to government and we needed to find some way of softening the return a bit. Through my Gaming Commission connections I had been aware that tabling gaming is not very profitable; on the other hand, it is a form of gaming that is very popular with the community. I suggested reducing the table gaming tax rate to give the operator a commercial incentive to keep table games going, to have more games available and a wider availability of games. Federal Hotels was quite happy with that and that is how that component of the package got in there. I can understand the negative public comment because people don't understand the subtlety of trying to put a package together, but that is the way it came about.

We were also looking to remove the tiering from the tax scales. That was an accident of the history in terms of the way the agreements had been negotiated back in 1993 and again it wasn't possible to get rid of them altogether because it would have changed the tax rates for the remainder of the period of Federal Hotels' existing licence too much, so you will notice from the agreement that there is another adjustment to the tax rates that comes in 2009.

The length of the licence was again a point of negotiation. Obviously I was trying to put the Government in the strongest possible position for the next round of negotiations in a decade or so time so I was trying to make the licence period as short as I possibly could but, realistically, Federal Hotels have another five-odd years to run on their existing licence and the Treasurer, as I say, had some policy objectives that he wished to achieve and in Federal Hotels' mind they had always had a 15-year licence going back to the original casino licence back in the late 1960s-early 1970s when it was negotiated. They had always had 15 years so in their thinking they were looking for a 15-year period that started from the end of the existing licence, so I needed to construct our approach to the negotiations in a way that didn't offend that objective of theirs too much.

It was a very typical negotiation. It was played pretty hard. It went on for a long time. Both sides had some key things they had to achieve. There were some areas where both sides were willing to compromise and, as I say, my judgment at the end of it was I was pretty comfortable in recommending it to the Government.

**Mr BEST** - In relation to the social aspect of the agreement, in terms of the social outcomes of the agreement how would you rate that, say, in comparison to other States? Would you see that we will get a better social outcome? Are we more proactive in a sense of what has happened or are we reactive trying to put something together to make something better than where it is? How would you rate it or what comments would you like to make about it?

**Mr CHALLEN** - I think we have historically been in reasonably good shape in relation to the social outcomes. Federal Hotels and indeed the other operators in Tasmania have, generally speaking, taken a quite cooperative attitude to the commission's and the Government's initiatives on player protection and problem gambling and so on. You will notice that there is in the new agreement a good faith commitment on the part of Federal Hotels to continue to support the Government's efforts on player protection and the like. I didn't regard that as absolutely essential because I have had that agreement from them. But you have to contemplate the possibility that the ownership of Federal Hotels might change. We are talking about an agreement that has 20 years to run from today and that is a long period of time in terms of the life of a company like this and I was looking for ways of locking the good corporate citizen features of Federal Hotels into the agreement but, having said that, I would have to say that we have an ongoing dialogue with Federal Hotels and we have not had any problems with them in terms of getting support for our player protection measures.

We did discuss through these negotiations where gaming machine technology is going in the future and we have talked about the possibility of using developments in gaming machine technology to more effectively implement some of the player protection measures and I think one of the things that is likely to happen in the industry over the next few years is that card-based machines will become the standard instead of machines with note acceptors or the common tokenised coin-based machines that are in the market at the moment. Those kinds of changes in technology give you the opportunity to monitor individual players' behaviour in a way that I think will allow us in the future to identify problem gambling behaviour before it becomes a huge issue and maybe through some light-handed and subtle means encourage individuals who might otherwise develop problem gambling habits to seek some counselling, for instance.

One of the other issues that is quite difficult for us to manage is the exclusions provisions in the Gaming Control Act. We have put a lot of effort into try to make that process work well and I'd have to say that while we try hard it is not hugely successfully, but card-based gaming will make it very easy to make the exclusions processes work. I have had all those debates with Mr Farrell and his colleagues through these negotiations and he is quite supportive of going down those paths.

On the social issue, I think the other thing that is important is that the other group that is very much affected by this agreement are the operators of the venues. I was looking for some improvements through these negotiations in the sort of deal they get. You will see in the deed that there are two important things there. One is a lot more flexibility in terms of the style of gaming operations that individual venues can have. So instead of basically being told, 'Here's the package you're getting', they will have much more capacity under the new arrangements to choose the types of machines and games that they want. I also felt that times had changed a little bit in terms of the recovery of costs from the venue operators. One of the things that you will see in the deed is that we have reduced the amount of cost recovery for the central system costs and the communication costs. When the new arrangements are implemented, assuming they are, venues will effectively pay for the costs that occur in their own venue and not for costs that are involved in the maintenance of the overall system that sit back in Federal Hotels' offices.

I think they are the main things, Mr Best. I am just looking at my summary of the agreement to make sure I haven't missed anything important. If I have any bright ideas I might come back in a moment.

**Mr BEST** - Just to finish off on that, if I can. In the context of the financial view in terms of what we are receiving in relation to, say, other States, how does our deal stack up?

**Mr STURGES** - As a package.

**Mr CHALLEN** - As a package I think it stacks up well. Our tax rates are not the very severest in the market; I think South Australia made some moves recently that will put them in that area. I think we get quite good returns from tax in terms of the size of the market and the fact that we have constrained the individual operations to be quite small. Going forward, the maximum number of machines in a hotel will be 30 for the life of the new arrangements, and by interstate standards they are not large venues. I think you have to take into account the size of the market, the style of gaming and so on in terms of looking at the returns and the fact that Federal Hotels provides two casinos that have significant parts of their operation devoted to styles of games that are costly to run and not very profitable - you have to reflect that. These are judgment calls and you can't start these negotiations with a blank piece of paper; you start from the arrangements that you have inherited, in part from yourself in your earlier negotiations but in part from things others have done in years gone by. As I said, I think we produced a quite acceptable outcome.

**Mr WILKINSON** - Don, you have been involved in previous negotiations with Federal?

**Mr CHALLEN** - Yes.

**Mr WILKINSON** - In those negotiations you would have gone in with key things that you wanted to come out of negotiation with. Were they the same key issues previously that they were this time and, if they were or weren't, what changed between, say, 1993 and now?

**Mr CHALLEN** - They are very different. The 1993 negotiations were quite unusual really because the policy instructions that I had on that occasion were very different to what we now have. That was all wrapped up in the decision the Government had made that it was willing to take to Parliament legislation to authorise the extension of gaming machines outside the two casinos but it was only prepared to do so if it could achieve through those negotiations a series of important undertakings from Federal Hotels. Those negotiations occurred much more quickly: from the moment I first got instructions from Cabinet to the completion of a deal was just a matter of days in that case. It all occurred very quickly and it happened in the public gaze. Everybody knew that these negotiations were going on.

**Mr WILKINSON** - What were the key things that were not negotiable that you took into this negotiation?

**Mr CHALLEN** - From our side?

**Mr WILKINSON** - Yes.

**Mr CHALLEN** - The cap and an increase in the tax rates were probably the only things that were truly non-negotiable from our side.

**Mr WILKINSON** - How many 'key' things did you have to give away for that part of the negotiation?

**Mr CHALLEN** - This is like the inside of the confessional.

*Laughter.*

**Mr WILKINSON** - There's not a firing squad outside if you tell us.

**Mr HIDDING** - I wouldn't trust Father Wilkinson either!

*Laughter.*

**Mr CHALLEN** - My opening position in the negotiations was much tougher in terms of the tax-take, as you would expect and I was looking for a much shorter period of the extension of the licence. I didn't think the outcomes on either front were anything other than perfectly reasonable but I have had a lot of experience of negotiations and so has Mr Farrell.

**Mr WILKINSON** - Yes. That was the other question and please tell me if you can't answer it or don't feel that you should answer it for obvious reasons. What things did they bring to the negotiating table and give away that you were quite happy with?



**Mr CHALLEN** - They obviously gave up some control over what goes on in individual venues so we have made their business model a bit more complicated. They have taken on some additional costs that I don't think they contemplated at the beginning of the agreement in terms of what they can recover from venues. Mr Farrell, I think, would have preferred a longer-term agreement if he could have achieved that. He took some persuading that it was reasonable for us to increase the licence fees and tax rates as much as we did. There were many things, though, that he readily agreed to; for instance, the support for player protection measures and so on. The restructuring of the tax rates he wasn't greatly troubled by. That could have been done in a revenue-neutral way but as it happens it wasn't.

**Mr WILKINSON** - Was part of the agreement for Federals to proceed with building to, let us say, a better standard the development up at Coles Bay or any other developments like that or didn't that form part of the negotiation?

**Mr CHALLEN** - I didn't feel I was extracting that commitment. I felt that Federal Hotels had effectively already committed themselves to do that in terms of their public announcements and their discussions with business leaders and so on. It was no secret that they were thinking about that development, but I thought it was important to lock it into the agreement so that it was very clear that it was going to happen if this deal was going ahead. Mr Farrell's position on that was, 'Yes, we want to go ahead with the Coles Bay development and fully intend to but we couldn't possibly do that if our exclusive licence was to run out in December 2008'. I think that is a reasonable position. You wouldn't go ahead with a \$25 million development now if your licence only had five years to run.

**Mr HIDDING** - Wouldn't you? Why not? Cross-subsidisation?

**Mr CHALLEN** - Yes, I think there is some cross-subsidisation. It is not my area of expertise, Mr Hidding, but my expectation would be that a development like that would be likely to run at a cash deficit for a number of years - they typically do - and you would expect that the cash that is being generated from other parts of the business would be needed to support that new business through its difficult period and presumably you would then want a period of five or 10 years to make your business case look good. I wasn't greatly surprised by the position he took. On the other hand, I thought there would be a level of disappointment in the community if Federal Hotels changed its mind so I locked it into the agreement. It wasn't a difficult thing to extract.

**Mr WILKINSON** - I was going to ask about the cap - I know your comments have probably been stretched to suit certain people's slant on things in relation to the number of machines out in the community. Was there ever an argument that there should be no more machines out there at all? In other words, there couldn't be any further rollout at all?

**Mr CHALLEN** - I think the Treasurer would have been happy with me if I had managed to achieve an outcome in which the cap was the current level of machines -

**Mr WILKINSON** - Sure.

**Mr CHALLEN** - but I didn't do that.

**Mr WILKINSON** - Did you endeavour to?

**Mr CHALLEN** - It was part of my opening position, yes, but I didn't have a realistic expectation of achieving that. I am not sure in my own mind that it would have been a good outcome. Again, it is important to remember that there are a lot of current operators out there in hotels and clubs and potential ones who would have been very disappointed by that. In fact, I think many of them are probably disappointed by the fact that there are only another 290-odd machines to go and they will be soaked up very quickly.

I just had in mind, with my Gaming Commission hat on, there is a steady flow of approvals coming through for new venues and for existing venues to increase the number of machines. There is still a relatively low proportion of venues out there that have machines at the 30 and 40 limits. I thought it was important that we left a little bit of scope for a small increase in the numbers just to soften the level of disappointment on the part of operators.

**Mr WILKINSON** - How did you arrive at that figure? Was it just a figure that was plucked out of the area that doesn't seem right?

**Mr CHALLEN** - Well, I started at zero and Mr Farrell started at a much larger number and we held for a period of time. Again, I am sure you are all experienced businessmen and you know what these negotiations are like. You don't negotiate these things one thing at a time; we are negotiating a package and bits of the package are being adjusted all over the place. You can't pick these things to bits because they are negotiated as part of a package and it was one of the things that we were still haggling about right down to the last stage of the negotiations. To be honest with you, it is hard to remember how we got to that particular number but in the end I thought I had pushed Mr Farrell as far as I could. Obviously I am keeping in touch with the Treasurer through this process and getting readings from him about how he feels things are going and I guess I get to a point where I think I can probably get his approval if I take that back to him and one day he finally says, 'Yes, okay'.

**Mr WILKINSON** - Was it one of the most drawn-out negotiations that you've had?

**Mr CHALLEN** - No. It happened over a period of months and it was pretty active. I was seeing Mr Farrell and his colleagues pretty regularly and we were talking on the telephone and had e-mails flying back and forth. Towards the end he was overseas for an extended period - I forget now, two or three weeks - but the telephone calls were being exchanged at midnight my time and midnight his time. I've had more difficult and protracted negotiations than this but this was pretty robust.

**Mr HIDDING** - Going back to the flavour of the negotiations and my first question talking about the term of a deed and the feeling that in real life this organisation has this public licence to do this for their life, however long they want to. There are quite a number of people out there who believe - and we have submissions from a number of organisations - that in the next few years there would be an opportunity to make some points of view about gaming machines in Tasmania. These included social organisations, as well as hotels, who felt disaffected that they couldn't get licences and

who felt that in due course they would get their day in court. They were gazumped by a secret process and now they are told that there is a 20-year deal. You are out of the frame now for 20 years if it goes through the Legislative Council. Then you raised two matters a minute ago - I am starting to feel that the whole thing is a bit bizarre, a bit tongue-in-cheek. Firstly, you went in there trying to get a shorter period for the deed. They wanted 20 years and I take it you probably wanted 10 years, a figure to maintain some control, and you ended up with 20 years. It might have been 30 years and 15 years, but you ended up with 20 years. But a moment ago - and the *Hansard* will show - you said that you wanted to place the Government in the best possible position so whoever is in government in about a decade from now can renegotiate. So the 20-year deal isn't a 20-year deal at all!

**Mr CHALLEN** - It is the remaining term of the current licence plus 10 years plus what is called a five-year evergreen - an annually renewable notice. So about 10 to 12 years from now the government of the day, I think, will be in quite a strong position to say to Federal Hotels that we want to start talking to you about what your next licence period looks like or, if the government of the day wishes to do this, to give them five years notice that they won't be renewing their licence. I think that will put the government of the day in a very strong position indeed, if it needs to be in that position. I think these are probably issues you need to discuss with the Treasurer. At the end of the day, as I said, I had instructions in terms of some policy direction that I was given and I was negotiating within those instructions.

**Mr HIDDING** - And we don't want to go there. Can you comment on the need to conduct all these negotiations in secret? I am not talking about the detail of the negotiation but the fact that it was actually happening. You said a moment ago that the 1993 one was done in the blaze of the public and put together in a period of time, everyone knew what was going on. Why was it necessary to do this in secret?

**Mr CHALLEN** - You will have to ask the Treasurer that.

**CHAIR** - Could I endeavour to bring together the discussion we have had in relation to terms of reference (a) and (c). I want to conclude something along these lines for my personal benefit; others members of the committee will feed off this in some way or other I suppose. If I am trying to measure the success of the negotiations and the return to the taxpayers, the words I have are something like 'the success of the negotiators can be judged by the returns to the State in the form of social and financial gains. The financial return to the State can be accurately assessed by measuring the tax rates achieved in the new agreement against tax rates in other jurisdictions'.

**Mr CHALLEN** - As I said, you can do those comparisons but you need to be a bit careful because, on the one hand, some jurisdictions have up-front licence fee payments and we haven't structure it in that way. The venue limits of 30 and 40 and now the fact that there is a statewide cap on the number of machines is a major constraint which means that you can't extract as much in tax as you could if there were no such limits.

**CHAIR** - The third point I wanted to make was that Federal Hotels has submitted a paper prepared by the New South Wales Treasury office and that spells out the various tax rates in different jurisdictions. Is that the most authoritative table available or is there another means of measuring and comparing the tax rates in different States?

**Mr CHALLEN** - I am not aware of that paper; I may have seen it but I don't recall. If the New South Wales Treasury did it, I am sure it is a very good quality paper.

**CHAIR** - Could I then ask you how you would measure it. What authority would you use to measure the tax rates, the tax takes between the various States? What can the Tasmanian Treasury provide for us?

**Mr CHALLEN** - What you would do is you would work out the average tax rate that applies at the level of turnover that exists in the Tasmanian market and then you would have to spread the up-front licence fee payments that occur in some other States over the life of the agreement to try to equalise that effect out.

**CHAIR** - And obviously you have done that.

**Mr CHALLEN** - No, we haven't. What we have done is we have compared tax rates in the other jurisdictions. As I explained to you, because these comparisons are not easily done on an apples with apples basis and we didn't negotiate from a blank sheet of paper I didn't think it was terribly helpful to do that. In fact it tends to help Federal Hotels more than it helps us because on the face of it our tax rates look reasonably high. The issue for us was, given our starting point and given the policy direction that I was operating within, did I extract a good deal in terms of financial return. My judgment is I did.

**CHAIR** - I don't have the backing of Treasury and I don't have your skill and training but I want to make a judgment as to whether you achieved a good result or not.

**Mr CHALLEN** - Yes, I understand that.

**CHAIR** - How do I do that? If you cannot provide me with something to measure against, am I to take your word as the sole decision maker in relation to this matter?

**Mr CHALLEN** - I am not sure how I can help you with that, Mr Fletcher.

**CHAIR** - So there is no way of measuring it?

**Mr CHALLEN** - Well, there must be a way but sitting here at this moment the question just having been put to me, I can't provide you with a useful methodology on the spot.

**CHAIR** - I wonder whether you would give some consideration to that and perhaps return to the committee with some suggestions.

**Mr CHALLEN** - I will.

**CHAIR** - Thank you. Can we move on to - and I think part of it has already been covered - (b), the negotiation of the deal and the need for secrecy in relation to that. Does anyone wish to pursue any further questions in relation to that matter?

**Mr HIDDING** - It was a policy matter and that is not for me to ask Mr Challen about. It is not fair on Mr Challen.

**CHAIR** - Then we might move on to (d), the non-competitive nature of the negotiation.

**Mr HIDDING** - It has been done as well.

**CHAIR** - It has been done.

**Mr HIDDING** - There was never anyone else in the frame.

**Mr WILKINSON** - Can I just ask one question on that. Were you aware, Don, of anybody else interested in going into competition with Federal?

**Mr CHALLEN** - No.

**Mr WILKINSON** - There is some talk - you often here it, whether there is any substance in it at all - that Tabcorp was interested.

**Mr CHALLEN** - I haven't heard that.

**Mr HIDDING** - Tattersalls?

**Mr CHALLEN** - I haven't heard that.

**Mr HIDDING** - They have been running around South Africa trying to get in lately.

**Mr CHALLEN** - I have had lots of dealings with Tattersalls over the years and they have had plenty of opportunity to tell me but they never did.

**Mr HIDDING** - They didn't want to come back home.

**Mr CHALLEN** - Maybe.

**CHAIR** - Can we then move on term of reference 5 which deals with other issues and related issues and we might move on to the role Mr Challen plays as chairman of the commission at this stage. Are there any questions?

**Mr HIDDING** - We have had a number of submissions that go to this matter of the on-granting of licence. We are granting here a licence to Federal who are on-licensing various hotel owners to run gaming in their establishments and I am interested that you said earlier that on this occasion you took that into consideration. You wanted to improve their lot in these negotiations. That of course says that you were considering the 105 establishments. There are a lot of establishments out there that would want to be included in that 105 or be added to the 105 and of course from those who dip out from time to time or don't seem to be able to crack the holy grail for some reason or other, there are perceptions of insider knowledge and a bit of a club and you can't break in. There are 105 establishments. How many people own multiple sites - in other words, is there one organisation that owns 20-something sites, for instance?

**Mr CHALLEN** - I would have to take the question on notice. There are certainly some companies that own more than one site and obviously you would be aware that the Vantage Group owns a number of sites, but I would have to take the question on notice.

**Mr HIDDING** - Are the people to whom the licences are granted part of the public record in your Gaming Commission report?

**Mr CHALLEN** - No, they are not a matter of public record in the report, though, as a requirement in the act, before a licence is granted the applicant must advertise in the newspapers, so the holders of licences are not great secrets. I think, from memory, the commission has made those lists publicly available in the past.

**Mr HIDDING** - Could you make a list available to this committee?

**Mr CHALLEN** - I could certainly make it available to the committee.

Could I just correct what might be a misunderstanding? Under the Gaming Control Act it is Gaming Commission's responsibility to license individual venues, but the process that is used to determine whether an operator will be licensed does not focus at all on commercial considerations. It is about their reputation, integrity, financial position and so on. Essentially the commission considers applications from venue operators purely in terms of the powers that the act provides to the commission. Whether an individual venue actually gets gaming machines is a commercial decision that Federal Hotels takes. The act gives the commission no role in that process at all.

**CHAIR** - I understand that. Your statement just then, as I heard it, was that the Gaming Commission licenses venues. In fact, it licenses the operator of the venue, to be correct.

**Mr CHALLEN** - Yes, a bit of casual language - we license operators.

Mr Hidding - I think probably also some casual language - used the term 'onlicensing from Federal Hotels. I just wanted to correct that because Federal Hotels don't get to license anybody; the commission does that. All they do is make a commercial decision that they are prepared to put gaming machines into a particular venue.

**CHAIR** - This may be outside the realms of you as Gaming Commissioner - I am sure you will change hats if that is the case - there is some concern and I have some concern with regard the operator being able to compete in the marketplace as a licensed venue operator at the same time and I notice in 1994 Victorian legislation was amended to prevent that from happening. What is the case for that similar amendment being passed in Tasmania?

**Mr CHALLEN** - It is a policy matter that I think you would have to take up with the Treasurer. The issue is one that has concerned the commission and the commission has placed some conditions on the involvement of Federal Hotels through the Vantage Group in the operation of licensed venues - when I say 'licensed' I mean venues that are licensed for gaming machines. The approach that the commission has taken is to impose a series of conditions that are designed to ensure that venues in the Vantage Group are not favoured relative to any other venue. For instance, this goes back to July 1999 when we received the first application for approval of gaming machines and keno at a location that is in that group. Could I read the conditions:

'In respect of gaming operations the relationship between a licensed premises gaming operator owned by the companies' -

meaning the Federal Hotel Group -

'must be identical in character to that which applies to the licensed premises gaming operators not owned by the company. The gaming operator must enter into a contractual relationship with a licensed premises gaming operator owned by the companies that is consistent with the standard contract between a licensed premises gaming operator and the gaming operator that has been approved by the commission under section 77 of the Gaming Control Act.'

So we are saying to them, 'You're not allowed to set up a contractual relationship with your own venues different from that that applies to all the rest'.

'The gaming operator must not favour a licensed premises gaming operator owned by the companies over any other licensed premises gaming operator in its dealings, including the supply, configuration and over any other licensed premises gaming operator in its dealings including the supply, configuration and maintenance of gaming products. A licensed premises gaming operator owned by the companies must be part of a marketing group which is available to other licensed premises gaming operators'

so we didn't want them creating a new -

**Mr HIDDING** - Oasis mark 2.

**Mr CHALLEN** - Exactly, a marketing group that only their companies were in. It continues:

'Licensed premises gaming operators owned by the companies must not represent more than 30 per cent of the venues in a marketing group'

So we forced them to spread their own companies around the different marketing groups.

'Australian National Hotels, that is the Federal group, and its related companies will not exercise its voting power within a marketing group to prevent a licensed premises gaming operator not owned by the company as joining that marketing group'

so it wouldn't let them exclude somebody else from one of the marketing groups. Then we put a limit on the number of machines that could be owned by companies within the Vantage group. It started out as 15 per cent of all gaming machines in hotels and the total number of machines gradually increased over time. The limit since 1 July 2002 has been 25 per cent, so we have actually put a cap on the number of machines that can be in hotels within their group.

These conditions were applied in relation to an application for one specific venue, the first of them, but we have made it clear that we reserve our rights to put conditions on the approval in each and every case, though we haven't found it necessary to do so since then. That was designed to send a very strong signal that if there was a huge growth in activities under their broad control then we may seek to limit that.

**Mr HIDDING** - They have a self-imposed rule to not buy any premises that are not currently licensed for gaming machines.

**Mr CHALLEN** - I wasn't aware of that.

**Mr HIDDING** - That is a self-imposed rule. That is almost an offer to include that in their conditions - no, that is a condition when you grant the licence.

**Mr CHALLEN** - Effectively, yes. The reality is that the Gaming Commission's responsibility only extends for premises that have liquor licences that also are licensed for gaming machines and keno so it wouldn't gain us any additional leverage. I might also say that we have written these conditions in such a way that a breach of them would be a very serious matter for Federal Hotels.

**CHAIR** - Mr Challen, can you tell me why the commission has taken a decision to increase the number from 10 to 25 per cent?

**Mr CHALLEN** - You mean the limit on the number of machines?

**CHAIR** - Yes.

**Mr CHALLEN** - As I say, this was first granted in 1999, which was relatively early in the rollout of gaming machines to hotels and clubs, and we didn't want them to grow more rapidly than the rest of the market.

**CHAIR** - Currently Federal Hotels or Vantage have five units, as I understand, which with 30 machines would be 150, yet 25 per cent of 3 800 is 950. Surely that envisages a massive rollout of Federal Hotel machines in the not too distant future if you have recently increased the limit to 25 per cent.

**Mr CHALLEN** - No, we didn't recently increase it. These limits were set when we first considered this matter back in 1999 and they have never been changed. It hasn't been necessary for us to reconsider this because they have never come anywhere near touching these limits. The judgment that the commission made at the time was that these limits were appropriate and if they looked like they were going to be anywhere near 900 machines you can be very sure we would revisit it.

**CHAIR** - Well, 25 per cent of 1 300 is somewhere around about 950?

**Mr CHALLEN** - Yes, but you have to remember that that total number that you are talking about includes the machines in the casinos. I just don't have in my head the number of machines that are currently out there in the external venues and that is what this applies to. This applies to non-casino machines.

**CHAIR** - Twenty five per cent of the non-casino machines. Are there any other questions?

**Mr HIDDING** - It is still 600-odd.



**Mr CHALLEN** - It sounds like about that but, as I say, it is not a practical limit anyway. They have never been anywhere near it.

**CHAIR** - So there has been no stimulus or no request to increase from 10 to 15 to 25 per cent, it has just been a decision of the Gaming Commission that it ought to do that.

**Mr CHALLEN** - I will just say that when we considered it in 1999 they seemed like reasonable limits. We haven't found it necessary to revisit them because they have never come within cooee of the limits.

**CHAIR** - I may well have misread your evidence. I thought that you explained to the committee that there had been three steps to increase percentage over time. Are you saying now that there weren't three steps, that there was only initial -

**Mr CHALLEN** - There were four steps. We imposed a condition that said 'Until 30 June 2000 your machines can't represent more than 15 per cent of the total machines in hotels, and until 30 June 2001 it was 18 per cent, and then until 30 June 2002 it was 22 per cent, and subsequently it was 25 per cent'.

**Mr HIDDING** - Were they negotiated?

**Mr CHALLEN** - No. The commission just imposed them.

**CHAIR** - It is now - and I accept this as reasonable, it is just a better understanding of it - only the machines in hotels that are taken into account, not hotels and clubs.

**Mr CHALLEN** - Yes, that is right.

**CHAIR** - But the major machines are in hotels.

**Mr CHALLEN** - Yes.

**CHAIR** - Any further questions in relation to that?

**Mr WILKINSON** - No, not in relation to that. Just one question and it has been mentioned in a couple of the submissions. Given the composition, with you being in charge of the Gaming Commission, the Tasmanian Gaming Commission can't be relied upon to act independently of government. I understand that has been an issue; would you like to comment on that?

**Mr CHALLEN** - I have commented at length on the record on this issue a couple of times before, including in both your and Mr Fletcher's presence at the Estimates committee, so I won't go on at length. My colleagues on the Gaming Commission and I are charged with statutory responsibilities under the Gaming Control Act and like all statutory officers we are extremely serious about them. There are many of us who are on the public payroll who have to manage a role of advising government on the one hand and carrying out statutory responsibilities on the other. My colleague, the Commissioner for Licensing, has to do that; my colleague, the Commissioner for Taxes, has to do that; there are many officers in other departments who carry those dual roles as well. Others aren't accusing them of having a lack of independence. The second point I would make is -

**Mr WILKINSON** - I don't think they are accusing you of having a lack of independence. What they are saying is that justice has not only got to be done but it has got to be seen to be done.

**Mr CHALLEN** - Some people may perceive there to be an issue when there isn't. But the second point I would make is that if you look at the set of responsibilities that the Gaming Commission has under the Gaming Control Act, it has no impact on the revenue to government in any way. We are there to licence individuals, to licence operators, to carry out disciplinary functions, to impose requirements that are in the interests of player protection and problem gambling and so on. We do not have a role in deciding where machines will go or how many machines there will be, except for one tiny example in that the deed gave us a role in determining whether the number of machines in individual venues should be more than 30 or hotels and 40 for clubs after 30 June last. I will just say to our detractors, observe our behaviour. We considered that issue in terms of its community impact and in terms of player protection issues. As early as when Mrs Smith's committee was taking evidence I articulated the view of the commission at that time that 'we will take a lot of persuading' - that was how I put it - that that limit should be increased.

Finally, Mr Chairman, I would just say that I think there are some real benefits in having the person who is responsible for the staff that service the Gaming Commission being part of that body because it gets me involved and gives me a very active interest in what is going on in the commission. I ask people to observe the behaviour of the commission. What have we done that people are unhappy about? Are there any ways in which we have failed to carry out our responsibilities as fully as the Parliament might have expected? If you wish to read me at length I am on the *Hansard* from the Estimates committee.

**CHAIR** - You are, and Mrs Smith's statement was a good summary of it, I thought.

**Mr HIDDING** - My question is probably not a gaming commission one but more in your other role.

**CHAIR** - Can I deal with the Gaming Commission while we are sweeping up there?

**Mr HIDDING** - While he's got that hat on.

**CHAIR** - Absolutely. The act provides the minister with the capacity in an open and transparent way to provide you with an instruction. I understand that has never ever happened.

**Mr CHALLEN** - No, never.

**CHAIR** - Suppose that this 25 per cent was seen to be excessive or it was being exploited, would it be within the capacity of the minister to issue an instruction in relation to that matter? Would that impact on the sovereign risk concept as applied to the agreement between Federal Hotels and the State?

**Mr CHALLEN** - It is an issue on which I think we should take legal advice to be sure, but I would be reasonably confident that it would be within the minister's power to issue such a lawful direction. I do not think it would be a sovereign risk issue. It doesn't go to the heart of the deed with Federal Hotels; it is something that is extraneous, if you like. The way in which they have chosen to operate that is not contemplated by the deed. So I do not think it would be a sovereign risk issue.

**Mr HIDDING** - I would like to follow up on that. What is being contemplated? From our evidence this morning it would appear that they have purchased four or five key properties for quite separate commercial reasons. They have to wash their own face; he wants them to be a business unit in their own right and he's got his eye on one or two more. But for all that, he is a smart and canny businessman and if, for instance, once this deed goes through and he is a bit more relaxed about his future and the rest of it he was offered the entire Dixon-owned chain of hotels in Tasmania - which is a substantial number of hotels almost in every nook and cranny of Tasmania - one contract and he would be up to his 25 per cent very quickly.

**CHAIR** - He's got to be under the cap.

**Mr HIDDING** - Of 25 per cent, yes. In reality the Gaming Commission has no concerns about that, can have no concerns.

**Mr CHALLEN** - No, that's not true. Federal Hotels would have to apply for a licence for each of those venues; the licence doesn't go with the change of operator.

**Mr HIDDING** - And they've currently got them. There's hardly a problem about their liquidity, they have the bankers.

**Mr CHALLEN** - It is hard to answer hypotheticals. The commission would look very hard at it and the issue of one operator, and that operator in particular suddenly becoming in control of a very large number of venues would be a big issue for us. My point, Mr Hidding, is that we have retained for ourselves the capacity to influence that decision.

**Mr HIDDING** - To say no on the basis of what - too many? Where does it say that in your riding instructions?

**Mr CHALLEN** - The commission has very wide powers under the act to impose conditions. We would consider the appropriateness of that event occurring in the circumstances of the time. We would look to what was in the broader public interest. I don't say what our decision would be; it is not my decision, it is a commission decision. There are three people involved and they would take careful advice on the issue before they made up their minds. But it would be an issue. I don't think there is any doubt about that.

**Mr HIDDING** - Absolutely it would be an issue.

**Mr CHALLEN** - A member of your profession on this side of the table would have declined to answer that because it was a hypothetical question. I don't have the sophistication to duck and weave.

*Laughter.*

**Mr HIDDING** - We should be so lucky to lack your sophistication.

*Laughter.*

**Mr HIDDING** - I have one more question - hat off now; back to Treasury. Why would the National Competition Council in its 2002 assessment of these matters - and I am going through some submissions here because it is probable that we will not get them all in here to speak to these things and I would like to be able to answer these people or allow you the right to answer these people. This person has pointed out that the NCC in its 2002 assessment said, and I quote:

'Tasmania has stated that it does not intend extending or renewing the licence once it has expired.'

And then it goes on to say again, and I quote further:

'The NCC believes that Tasmania has "no intention of entering into any more exclusive arrangements in the gaming area" '.

Have you any idea why the NCC would make those judgments so therefore form various views about competition matters in Tasmania in regard to gaming? Could they have come off the wrong base there? Have they been led astray?

**Mr CHALLEN** - I would only be speculating. In the early days of the NCC's activity they took a lot of interest in what you might call 'agreement specific' pieces of legislation, so things like the Copper Mines of Tasmania act and our deed in the Gaming Control Act, and indicated to the States that where those agreements were allowed to run their course but not renewed the commission wouldn't make too much of an issue of it. I think there were some cases where they felt that some early action was needed but my recollection - and this is going back quite a few years now - is that in Tasmania's case they accepted that they would be allowed to run on. So it is possible that they were reflecting an expectation on their part that if things were to be different they would need to hear from Tasmania.

**Mr HIDDING** - This is last year's publication?

**Mr CHALLEN** - I don't know.

**Mr HIDDING** - I wonder if I could ask you to have a look at that NCC assessment 2002.

**Mr CHALLEN** - All I can tell you is that if that was their earnest belief at the time, right now it is incorrect.

**Mr HIDDING** - But wasn't led astray by you?

**Mr CHALLEN** - They wouldn't have been led astray by us because we are extremely careful what we say to them but, in any event, we obviously have an issue with the NCC now and we have either provided to them or are about to provide to them - I just can't quite

remember where it is in the process - a justification in terms of the policy decisions the Government has made showing why believe that they are in the public interest.

**Mr HIDDING** - On the deed?

**Mr CHALLEN** - Yes.

**Mr HIDDING** - Where are we at with their inquiries on that?

**Mr CHALLEN** - As I say, I am not sure whether we have recently submitted it to them or we are about to but it is in the process.

**Mr HIDDING** - Did they write to Treasury?

**Mr CHALLEN** - Well, we provoked this with them. The sort of relationship all the States have with the NCC is that we keep a very open dialogue and when there are issues that we think they may need some explanation on or to have some concern with then we will them. So my senior colleagues are in more or less constant dialogue with them across a whole a range of issues and this is just one of many and there are a number of cases where decisions have been taken by government and in some cases they have already been ratified by the Parliament. The recent amendments to the Liquor and Accommodation Act are a case in point where it is necessary for us to explain to them why there were public interest reasons for these occurring and this is one of them.

**CHAIR** - Don, I thank you for your attendance here this afternoon and for the good responses to our questions.

**THE WITNESS WITHDREW.**