

CLUB KENO ACT 1993

Review

*National Competition Policy
Review of legislative restrictions on competition.*

August 1997

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SUMMARY OF FINDINGS AND RECOMMENDATIONS

The report reviews the *Club Keno Act 1993* (the Act), as part of the program for legislative reviews for National Competition Policy commitments. The report was drafted for the Minister for Gaming, in accordance with terms of reference approved by the Premier.

The Act came into operation on 8 June 1993. The Act and its regulations authorise what would otherwise be an illegal gaming activity; outline the conduct and rules of the game; specify who may supply the game; and, specify in which locations it may be played.

Findings- The Club Keno game and the Objectives of the Act (see section 2)

Club keno is a form of gaming. Players buy a ticket and select up to 15 numbers (from 1-80). In each game a random selection of numbers (from 1-80) is drawn every few minutes and posted electronically. Combinations of matching selected numbers win a prize. Most prizes are paid out immediately, although the larger ones are paid later by cheque. Currently, club keno may be played only at gaming venues.

Club keno is supplied in Victoria by two suppliers, acting as one through a joint venture. Government revenue from the game is based on player loss and not an explicit licence fee to the suppliers. Taxes are paid into the Consolidated Fund weekly.

The broad market in which club keno is played is the gambling market. At the time that the Act came into effect, other legal forms of gambling operating in Victoria were lotteries, race wagering, bingo, lucky envelopes, raffles, and gaming on electronic gaming machines (EGMs). The temporary casino in Melbourne started operation in 1994, with the permanent casino opening in 1997.

Club keno is a fairly minor gambling product within the overall market. For example, in 1995-96, Victorian per capita expenditure on club keno was \$2.01, compared with \$93.22 on lotteries and \$366.70 on EGMs.

The three main objectives of the club keno legislation are

- to ensure the integrity of the game through specifying conditions under which it is played;
- to limit the social costs in providing this type of game; and
- to provide for maximum and secure taxation revenues from the game.

Two subsidiary and transitional objectives, which have been achieved, are:

- to assist Victoria's economic development, on the understanding that there will be (positive) flow on effects from the game; and
- to authorise the conditions under which an otherwise illegal form of gambling is a lawful activity.

Findings: The restrictions on competition (see section 3)

There are two restrictions on competition in club keno legislation. The first restriction is to limit entry to the market to the estate of the late George Adams (Tattersall's) and to the holder of a gaming licence (TABCORP) under the *Gaming and Betting Act*. This restriction is a barrier to entry. The second restriction is to prescribe that club keno may only be played at venues where the operators are licensed to conduct gaming. This means that playing of club keno is restricted to gaming venues.

The effect of the restrictions is likely to be to retard market development and innovation in club keno (because of lack of contestability). An effect of the restrictions on venues is probably to limit the growth and popularity of the game (because it has restricted availability).

In terms of the Act's objectives, the restriction that limits entry as a supplier of club keno appears to:

- support the objective of maintaining integrity of the game to a limited degree;
- possibly support the Act's taxation objective; and
- supports the objective of limiting the social costs of gambling to a limited degree.

The restriction on locations where club keno may be played:

- is unlikely to support the integrity objective of the legislation;
- is unlikely to support the taxation objective of the legislation; and
- possibly supports the objective to limit adverse social impacts. It does this by confining the game to areas designated for gaming.

While the Act's objectives appear to met by the restrictions, there appear to be less than conclusive reasons for the scope and extent of the restrictions.

Findings - Premises for regulatory design and preferred option for achieving the Act's objectives (See section 4)

The restrictions on competition are likely to have generated significant incumbency advantages to the present two suppliers (who operate as one in a joint venture).

Complete removal of both restrictions in club keno is inconsistent with achieving the objectives of the club keno legislation. There appears to be a strong case for retaining a degree of government regulation of club keno.

Internally consistent regulatory design should be based on articulated premises consistent with the pro-competitive thrust of National Competition Policy. The premises are:

- Because of the intertwined nature of integrity and social policy objectives in regulation of the gambling industry, there is a presumption that government will choose to regulate it. In club keno, as in other gambling legislation, this regulation will set conditions for suppliers, as well as for the venues for playing.
- This regulation, like other forms of economic regulation should be directed to the viability of the *industry*, rather than a commitment to the viability of individual participants to it. In other words, existing suppliers should not expect that new gambling products or extension of existing products will necessarily be allocated to them. The government will, of course, meet contractual agreements and obligations now in place.
- Licence design should avoid creating inappropriate incumbency advantages that will preclude later competition. The process for gaining licences should be contestable.
- In principle exclusive gambling licences should be avoided, that is the licence should be granted to those who pass probity checks. Where licence exclusivity is granted, government is then in the role (inappropriately) of ensuring supplier viability. Making the market contestable will assist in capturing elements of product and market dynamics.
- The government may decide that licence exclusivity, despite its shortcomings, is preferred where there are either large initial licence fees and/or heavy provider capital investments (such as a casino). In these cases, licences should be contestable and time limited. In the case of club keno, neither condition (high initial fee and/or heavy provider capital investment) applies. An exclusive licence is therefore not warranted for club keno.
- Where there are restrictions on locations for playing club keno, designed to meet social objectives, these should be re-examined against the particular risks associated with that product. Such consideration might include the game's propensity to encourage problem gambling, the growth rate of expenditures on the gambling product and ways of excluding minors.

The preferred option for club keno regulation is to open licences to those passing probity requirements and to widen the venues at which club keno may be played. Widening the range of venues is necessary before contestability is introduced amongst suppliers. If venues are not extended, no potential supplier would be able to enter the existing gaming venue arrangement.

Features of the recommended option are:

- Club keno supply licences would be available to those who pass probity checks
- The permissible venues for club keno might include retail outlets or alternatively hotels and clubs without EGM machines.
- Pooling of prizes (ie enhancing the game's attractiveness) would be achieved by licensees in commercial arrangements.

The review panel judged that the three main objectives of club keno legislation would be met through adopting the preferred option.

On balance the benefits of wider supply (subject to probity) leading to greater market innovation and a greater range of venues were seen to outweigh the risks of lessening the restrictions. It was difficult to assess the risk (if any) of the social costs of widening the permissible venues for club keno. The review panel could not assess the risk to the (small) tax revenue base.

RECOMMENDATIONS

From our examination of the *Club Keno Act*, we conclude that the objective of the Act may be met by lessening the existing restrictions on competition. Based on the premises outlined above for consistent and pro-competitive regulatory design, we therefore recommend:

- **The permissible venues for club keno should be liberalised. Two options that the government might consider are extension of club keno operations to any club or hotel in Victoria, or, sale through retail outlets.**
- **The government should make available licences to supply club keno to those who pass the probity checks. Any pooling should emerge through the market (ie those with strong networks and attractive games). In club keno, there should be no exclusive licences.**
- **There should be flexibility in the 'rules of the game' to allow for potential competitors to propose new game rules.**
- **In view of the small relative size of club keno, and other legislative reviews of gambling regulation to be conducted, the government may wish to combine implementation with other changes to gambling legislation.**

1 Context of the Review

1.1 Why the Act is being reviewed

The review of this Act is one of an extensive program of legislative reviews in all portfolios. The Victorian Government has committed to complete these reviews by the year 2000.

In 1995, Victoria along with all other jurisdictions, signed the National Competition Policy agreements. These committed all Governments to a consistent national approach to fostering greater economic efficiency and improving the overall competitiveness of the Australian economy.

As part of the agreements, Governments adopted the following 'guiding legislative principle':

Legislation should not restrict competition unless it can be demonstrated that:

- **the benefits of the restriction to the community as a whole outweigh the costs; and**
- **the objective of the legislation can only be achieved by restricting competition.**

To implement this, Governments agreed to review, and where appropriate, reform all existing legislative restrictions on competition. Thus, application of this guiding legislative principle will help establish whether particular legislated restrictions on competition remain necessary to achieve public policy objectives. Legislative reviews will assist this through rigorous assessment of the costs and benefits of alternatives in achieving the objectives.

1.2 Terms of reference for the review

Each piece of legislation in Victoria being reviewed has approved terms of reference to guide its review. The terms of reference for this review are:

"The review of the Club Keno Act 1993 (the Act) and regulations has been commissioned by the Minister for Gaming, in accordance with the Victorian Government Timetable for the Review and Reform of Legislation That Restricts Competition, determined in accordance with National Competition Policy.

Legislation to be reviewed

The review will examine whether legislative restrictions on competition exist in the Act and regulations, in accordance with the Victorian Government Guidelines for the Review of Legislative Restrictions on Competition.

In particular, the review will provide evidence and findings through its report in relation to the following requirements:

- Clarify the objectives of the legislation. *The legislation makes provision for club keno in Victoria. The Act provides that 'participants' may conduct Club Keno games in venues already licensed (under the Gaming Machine Control Act 1991) for electronic gaming. The objective appears to be to provide a legal means for playing club keno and the review will identify and clarify the objectives.*
- Identify the nature of the restrictions on competition. *The Act defines participants as only two operators - Tattersalls and TABCORP. The game may only operate in venues that are already licensed for electronic gaming machines. The review will examine and expand on these two prima facie barriers to entry and further examine the Act and regulations for other restrictions on competition.*
- Assess and balance the costs and benefits of the restriction. *The review will assess the costs of identified restrictions against the benefits judged to be achieved from those restrictions.*
- Consider alternative means of achieving the same result including non-legislative means. *The review will seek to identify practicable alternatives that will meet the identified objectives.*

Reform options

The review should specifically address the appropriateness of modifying or removing the restrictions while meeting the requirements articulated in the identified objectives.

1.3 Administrative Arrangements

The review was prepared for the Minister for Gaming in accordance with the In-House review model contained in the Guidelines.

The review panel drafted the review report under the supervision of the Department of Treasury and Finance steering committee for all National Competition Policy reviews.

Consultation within government involved both the Taxation and Revenue Policy Division of the Department of Treasury and Finance and the Victorian Casino and Gaming Authority.

There was also consultation with the two key industry stakeholders - Tattersall's and TABCORP- who were sent copies of an interim report and terms of reference.

The review panel and the steering committee were also informed by an independent commissioned study on the regulatory framework of the gambling industry as a whole.

2 Objectives of the Club Keno Act

An examination to clarify the objective of club keno legislation is the first task for this review, in accordance with the terms of reference. Prior to that, it is useful to outline the markets in which the Act operates and the existing regulatory arrangements. After specifying the objectives of the Act, we will go on to discuss the objectives and consider why they may have arisen. This will provide a focused framework for the following sections of the legislative review - identifying and assessing the restrictions on competition, and considering alternatives that will meet the identified objectives.

2.1 Background on Club Keno

Club keno is a form of gaming. Players buy a ticket and select up to 15 numbers (from 1-80). In each game a random selection of numbers (from 1-80) is drawn every few minutes and posted electronically. Combinations of matching selected numbers win a prize. Most prizes are paid out immediately, although the larger ones are paid later by cheque. Currently, club keno may be played only at gaming venues.

Club keno is supplied in Victoria by two suppliers, acting as one through a joint venture. Government revenue from the game is based on player loss and not an explicit licence fee to the suppliers. Taxes are paid into the Consolidated Fund weekly.

The Act came into operation on 8 June 1993. The Act and its regulations authorise what would otherwise be an illegal gaming activity; outline the conduct and rules of the game; and specify in which locations it may be played. The legislation gives the Victorian Casino and Gaming and Authority (VCGA) regulatory and enforcement powers in respect of the game. The Act also specifies the taxation regime applicable to club keno.

2.2 Market description

The broad market in which club keno is played is the gambling market. At the time that the Act came into effect, other legal forms of gambling in Victoria were lotteries, race wagering, bingo, lucky envelopes, raffles, and gaming on electronic gaming machines (EGMs). The temporary casino in Melbourne started operation in June 1994, with the permanent casino opening in 1997.

It is fair to characterise club keno as a fairly minor gambling product within the overall market.¹ For example, in 1995-96, Victorian per capita expenditure on club

¹ The focus of this legislative review is on the intervention of the *Club Keno Act* and regulations and their impacts on the club keno market, rather than impacts on the gambling market as a whole. If the market is too broadly defined, for instance, to include all gambling or even entertainment markets, then the analysis of government intervention becomes too diffuse. It is important to recognise that the

keno was \$2.01, compared with \$93.22 on lotteries and \$366.70 on EGMs. (*Australian Gambling Statistics*). The current legislation specifies that club keno is lawful only in premises which have been licensed as EGM venues. The club keno product, therefore, cannot be bought widely, like lottery tickets, but is better seen as a (minor) additional product at EGM venues. Recent taxation amendments implicitly acknowledge this by lowering the club keno tax rate to a similar one applying to EGMs in clubs.

In terms of supply there is effectively only one provider of club keno. Tattersall's and TABCORP, the two permitted "participants" (see regulatory arrangements below) have formed a joint venture for club keno and there is a common prize pool.

It is noted that, in the game of club keno, 'the size of the prize' is of importance. Club keno requires the selection of a set of potentially winning numbers by players, requiring a sufficiently large number of players to produce frequent winners.. These factors point to the advantage of scale in supplying this game and may affect the practicability of any changes to the current regulatory arrangements.

2.3 The existing regulatory arrangements

This review's focus is on the type of intervention that the government has in the operation of club keno. The main regulatory arrangements for club keno are:

- The game may be conducted by 'participants'. These are defined in the Act as Tattersall's and the holder of a gaming licence (ie TABCORP).² As noted above, the participants have entered a commercial agreement to run club keno, effectively as a single provider.
- Club keno may be played at 'approved venues' (within the meaning of the *Gaming Machine Control Act*), that is, places where the venue operator is licensed to have EGMs.

A framework of rules of conduct and compliance is imposed (operated by the Director of Gaming and Betting) to ensure that the game has integrity. Examples are the regulation providing that the club keno system must be approved by the Director of Gaming and Betting, and the regulation providing that all results of club keno games are displayed at all approved venues.

2.4 Objectives of the Act

The objectives of the Act are broader than a restatement of the purpose of the Act. The Act's stated purpose is to "make provision for the game of club keno" (section 1). Yet this Act is one of nine Acts regulating the gambling industry in Victoria and should be seen within the overall context of the industry. A recent review

legislative reviews are not examinations of possible anti-competitive conduct, which is covered by *The Trade Practices Act 1974*. Rather they are primarily reviews of *legislated* restrictions on competition and their effects.

² We note that there appears to have been no payment, such as a licence fee, for the operation of club keno.

commissioned by the Department of Treasury and Finance³ identified seven objectives generally apparent in Victoria's gambling legislation. These are:

- control over social costs
- provision of consumer protection on quality
- prevention of monopolistic exploitation of players through setting minimum payout rates
- maximisation and security of tax revenues
- assistance to designated industry and causes
- economic development
- reduction of crime associated with gambling.

The objectives identified above are wide ranging (and in some cases, potentially conflicting). While all are present - at least implicitly - in club keno legislation, the Act appears to have five main objectives. These are:

- to authorise the conditions under which an otherwise illegal form of gaming is a lawful activity.
- to ensure the integrity of the game through specifying conditions under which it is played. (We include in this objective the protection of players through specifying pay out ratios.)
- to limit the social costs in providing this type of gaming. (We include here the containment of crime objective outlined above. Club keno seems to present relatively few opportunities for criminal activity.)
- to assist Victoria's economic development, on the understanding that there will be (positive) flow on effects of the game
- to provide for maximum and secure taxation revenues from the game.

2.5 Discussion of objectives

Objectives in club keno legislation reflect the particular historic circumstances in which the legislation was enacted. The Act was passed at a time when the Government was facilitating a largely new economic activity, ie gaming as part of the lawful gambling industry. In the discussion of objectives that follows, we identify those objectives which no longer appear to be of primary importance. This helps establish the critical aspects of government intervention in markets and a preliminary

³ *A framework for National competition Policy reviews of gaming legislation*. Report prepared for the Department of Treasury and Finance, May 1997. This will be referred to as 'the Review' in this paper.

ranking of objectives. This will assist in the assessment of the costs and benefits of the present structure and its alternatives.

The first identified objective, *to authorise an otherwise illegal form of gambling*, is best seen as a transitional objective, which has been met by the passage of the Act. It is noted that Section 5(1) of the Act authorises the participants to conduct club keno in Victoria. Without this authorisation, the conduct of club keno would be unlawful, as club keno comes within the definition of a lottery. Unlawful lotteries are prohibited by section 5(1) of the *Lotteries Gaming and Betting Act 1966*. This objective, because it is transitional, will not be further discussed in the review.

The second identified objective, *to ensure the integrity of the game through specifying conditions under which it is played*, has resulted in an extensive and detailed system of regulation, probity checks, inspection and monitoring designed to produce a game of integrity. This intervention appears to arise, first because of a non-regulated market's inability, or perceived inability, to guarantee a fair 'product'. Consumers are guaranteed (by government's intervention) a minimum standard of integrity.

The Review noted⁴ that, unlike other entertainment industries (such as football), the government's intervention here makes it part of the gambling industry. That is, the government is supplying gambling industry services though ensuring a 'fair game', in contrast to other self-regulating industries. This is because of the government's concern to guarantee the fairness of the game, which is susceptible to criminal exploitation. Although a market solution to guaranteeing integrity could be considered, this would require the Government to vacate the field - a solution unlikely to be acceptable to either the government or the community.

A further aspect of the game integrity objective could be to aid tax collection. By having a game (and game suppliers/operators) 'with integrity', the administration of tax collection is simplified.

The third identified objective is *to limit or mitigate the social costs associated with this type of gambling*. Like the previous objective, this appears to be a common objective in all gambling legislation. In summary, these social costs are characterised as inappropriate levels of gambling expenditure and the rate of growth in gambling, resulting in adverse household impacts. Government has thus introduced gambling products over time and under restricted circumstances. A further social cost might be characterised as the potential for criminal elements in the game, whether through 'laundering money', or in providing a 'bent' game. Club keno, like lotteries, appears to presents few opportunities for criminals.

This objective is implicit, rather than explicitly stated in the Act. The chief way of attempting to control social costs is through regulation of the type of venue and through regulating access to gambling. Club keno legislation does this through, in effect, having this (small) game co-exist with licensed venues for EGMs. Thus, under

⁴ *Review, op.cit. p8*

the larger umbrella of regulation of EGM venues, conduct of the game is limited to approved venues and is not available elsewhere (such as lottery agents or in shopping centres). Similarly, because club keno is played in EGM venues, access to juveniles is effectively denied. Achieving the social objective through alternative means will be examined further in the cost benefit analysis of alternatives.

In considering this objective, it is worth noting three points. First, club keno has not shown strong growth or popularity. It may be that the concern about adverse social impacts is overstated for this form of gaming. Secondly, comparable games such as instant lotteries⁵ and bingo appear to be much more widely available without expressed concern over the social costs of these forms of gambling. Lastly, it is important to recognise that this Act reflects the introduction of a new game in a largely new industry where social impacts are a major concern. It may be that as the industry itself matures this objective will no longer predominate in the future regulatory design for club keno.

The fourth identified objective, *to promote economic development*, appears to be an implicit and minor objective in the club keno legislation. The current legislative arrangement, which legalises a game and then allocates it to two gambling suppliers,⁶ could be seen as a means of 'filling out the product line' for gambling industry suppliers. By contrast with, for instance, casino games, club keno games could only be described as a trivial adjunct to the gambling industry. Now that club keno is a recognised and lawful part of gambling, the objective, to the extent that it was important, is probably largely achieved. It is difficult to envisage any further steps the Government might take in this regard.⁷

The fifth objective of club keno legislation is *to provide for maximum and secure taxation revenues from the game*. Gambling tax revenues have, in the last five years provided a growing proportion of the State's tax revenue base. This growth rate is not expected to continue as the gambling industry matures. This objective, in part, underlies government facilitation of gambling as an economic activity in Victoria. This review does not focus on taxation *per se* as a form of legislative intervention.

It is important to put the importance of this objective in context for club keno. Taxation revenues from this game are currently \$3.4M, of a 1996-97 total gambling tax revenues of \$1.157.4M⁸.

We conclude from the above discussion, that club keno legislation has three interrelated major objectives concerned with integrity of the game, containment of social costs and the security of taxation revenues. Two further objectives, to assist Victoria's economic development and the authorisation of an otherwise illegal form of gaming, were transitional and have been achieved.

⁵ Instant lotteries are available at all Tattersall's agents (ie over 700 newsagencies).

⁶ It is important to note that the two suppliers operate as one in club keno, through a joint venture arrangement.

⁷ Tattersall's has submitted that liberalisation of venues at which club keno might be played could be part of the fulfilment of the 'economic development' objective.

⁸ Budget Papers 1997-1998

2.6 Findings

The three main objectives of the club keno legislation are

- *to ensure the integrity of the game through specifying conditions under which it is played;*
- *to limit the social costs in providing this type of game; and*
- *to provide for maximum and secure taxation revenues from the game.*

Two subsidiary and transitional objectives, which have been achieved, are:

- *to assist Victoria's economic development, on the understanding that there will be (positive) flow on effects from the game; and*
- *to authorise the conditions under which an otherwise illegal form of gambling is a lawful activity.*

Club keno is a minor form of gaming in the wider gambling market. The regulatory arrangements include defining the suppliers ("participants"), places where it may be played, and the rules under which it may be played.

3 The restrictions on competition

The second stage of this review according to the terms of reference, is to identify any restrictions on competition in the Act. This is followed by an examination of the likely effects of these restrictions and an analysis of the costs and benefits of the current restrictions.

3.1 The nature of the restrictions on competition

There are two identified restrictions on competition in this legislation. These are restrictions on who may conduct club keno and restrictions on where the game may be played.

Who may conduct club keno. Section 6 of the Act provides that club keno may only lawfully be conducted by "the participants". Section 3 of the Act defines the participants as the trustees of the will and estate of the late George Adams (Tattersall's) and the holder of a gaming licence under the *Gaming and Betting Act 1994*. TABCORP Holdings Pty Ltd (TABCORP) is the holder of the gaming licence under that Act.

The effect of these provisions is that club keno may only be operated in Victoria by Tattersall's and TABCORP, and thus the restriction is a barrier to entry. In practice the two suppliers operate as one through a joint venture agreement.

Where the game may be played. Section 4A allows the participants to conduct club keno in "approved venues" within the meaning of the *Gaming Machine Control Act 1991*. An "approved venue" is defined under that Act as premises on which a venue operator is licensed to conduct gaming. This means that the game may be conducted in licensed gaming venues, and thus the restriction is a barrier to other venues.

3.2 The likely effect of competitive restrictions

It is unlikely that the club keno restrictions on competition are significant to the broader gambling market. We have already noted that club keno is a relatively minor game within the whole industry of gambling. The Act and regulations are aimed at a small subset of this overall market. The likely effect of the restrictions identified above are:

Barrier to entry restriction. The restriction limiting suppliers to the market to two (effectively one through their joint venture) could have the effect of retarding market development and innovation in this game. Because the market is not contestable, existing suppliers could have little incentive to improve the game.

Restriction on locations where club keno may be played. The effect of limiting the playing of club keno to venues approved for EGMs could be expected to limit the overall demand for the game of club keno. Because club keno can only be found in

EGM venues, it does not compete with other gaming products such as lottery or bingo, or more broadly for the 'entertainment dollar'. An effect of this restriction could be that the club keno has not been fully promoted as it is an adjunct to the gaming machines.⁹

3.3. Findings

There are two restrictions on competition in club keno legislation. The first restriction is to limit entry to the market to the estate of the late George Adams (Tattersall's) and to the holder of a gaming licence (TABCORP) under the Gaming and Betting Act. This restriction is a barrier to entry. The second restriction is to prescribe that club keno may only be played at venues where the operators are licensed to conduct gaming. This means that playing of club keno is restricted to gaming venues.

The effect of the restrictions is likely to be to retard market development and innovation in club keno (because of lack of contestability). An effect of the restrictions on venues is probably to limit the growth and popularity of the game (because it has restricted availability).

3.4 Analyse and balance the costs and benefits of the restrictions.

In this part of the review, according to the terms of reference, the costs of the identified restrictions are evaluated against the benefits judged to be achieved by the existing arrangements.

A principal difficulty in assessment is that the costs and benefits cannot be directly quantified. The benefits and costs identified below were suggested in the development of the preceding section of the paper. They also reflect the result of external consultation with the two participants in club keno. The comments beside each identified cost and benefit reflect the view of the review panel.

⁹ The review panel notes that only 287 of the 587 gaming venues in Victoria currently have club keno available.

The costs and benefits of existing arrangements appear to be:

1. Restriction- Benefits and Costs	Comment
<p>Barrier to entry to operate club keno</p> <p><i>Benefits</i></p> <p>By having only two operators, this could provide ease of collection of tax revenues generated by club keno. In fact, under the present arrangement of the duopoly acting together, there is only one taxpayer. It is argued that minimising operational costs allows extra revenue to be taken up as tax. This might aid achievement of the taxation objective of the legislation.</p>	<p><i>The review panel notes that this rationale does not apply to any other form of taxed service outside the gambling area. That is, it is unusual to limit the number of suppliers to manage tax revenue collection.</i></p>
<p>The restriction could be implicit acknowledgment and support for a key feature of club keno- that is its attractiveness to players is (in part) the size of the prize. By limiting entry to two players (who then operate as one) the restriction might be thought to support the attractive features of club keno. If this restriction supports a bigger player pool, it might also be considered to aid achievement of taxation revenue.</p> <p>Additionally, this restriction could be thought to confer a private benefit on the two operators. Even where club keno is not profitable, the existing operators are likely to benefit from exclusion of contestability and any substitution that might occur if a rival operator offered a more popular game of club keno.</p>	<p><i>If 'size of the prize' is a critical feature, we would expect this pooling to occur without legislative intervention- it would be in the interests of rival operators to pool, or alternatively to seek to dominate competitors.</i></p> <p><i>The review panel notes that club keno taxes were \$3.4 M in 1996-97.</i></p>
<p><i>Costs</i></p> <p>The effective monopoly of club keno might act to deter market innovation and development from rival suppliers.</p>	<p><i>The review panel notes that allocation of club keno to two participants is likely to result in 'incumbency advantages'. This means that potential entrants could be deterred by the existing network and software support for club keno through EGM venues.</i></p>

Restriction- Benefits and Costs	Comment
<p>Restriction limiting the venues where club keno may be played</p> <p><i>Benefits</i></p> <p>This limitation on playing club keno (to EGM venues) could result in ease of putting in place controls designed to mitigate some adverse social impacts. Thus the restriction to EGM venues is effective in denying access to minors. Club keno, with draws for prizes every few minutes, may not be suitable at venues frequented by minors. Further, because club keno may only be played at a gambling venue, (and cannot be purchased at retail outlets) it could act to confine opportunities to gamble at dedicated venues.</p> <p>A private benefit of the venue restriction could be to the EGM venue operators, in that consumers must play club keno with them.</p>	<p><i>It is difficult to assess the importance of the adverse social impacts of club keno, except to note that it is a small part of total gambling expenditure.</i></p>
<p><i>Costs</i></p> <p>This restriction could retard the ability of rival operators to innovate and develop the club keno product.</p> <p>Because club keno is restricted to EGM venues and it is unpopular there, there appear to be costs of additional regulatory intervention. This 'props up' club keno for the existing operators (eg 1997 reduction of taxation rate).</p> <p>A further cost could be in lessening consumer choice in playing club keno through restricting its availability.</p>	<p><i>If the 'size of the prize' is an important qualitative feature of the game, then wider availability of it might encourage more players.</i></p> <p><i>The review panel notes that other gambling products such as lottery tickets and instant lotteries are widely available in Victoria. Only the sale of instant lotteries to minors is prohibited.</i></p>

3.5 Additional comments

In its analysis and consultation with industry stakeholders, the review panel noted three additional points:

- As indicated above, the restriction to a duopoly (acting together) in club keno, probably creates significant incumbency advantages, which, even in the absence of restrictions, may deter other entrants to the market. The extent of incumbency advantages was implicitly confirmed in the Tattersall's submission. This drew attention to the cost of buying and rolling out an alternative network and the current uniform 'branding' that has established the game's identity. Both these factors may present a commercial barrier to entry, even in the absence of legal barriers.
- At present, the spread or penetration of club keno is determined by the rules that limit EGM venues. To the extent that EGM venues are extended in future, club keno will have broader spread, even if it still remains bound to EGM venues. Both industry stakeholders identified the restriction of club keno to EGM venues as a binding constraint.

3.6 Findings

In terms of the Act's objectives, the restriction that limits entry as a supplier of club keno appears to:

- *support the objective of maintaining integrity of the game to a limited degree;*
- *possibly support the Act's taxation objective; and*
- *supports the objective of limiting the social costs of gambling to a limited degree.*

The restriction on locations where club keno may be played:

- *is unlikely to support the integrity objective of the legislation;*
- *is unlikely to support the taxation objective of the legislation; and*
- *possibly supports the objective to limit adverse social impacts. It does this by confining the game to areas designated for gaming.*

While the Act's objectives appear to met by the restrictions, there appear to be less than conclusive reasons for the scope and extent of the restrictions. The review panel noted that the restrictions on competition are likely to have generated significant incumbency advantages to the present two suppliers.

4 Assessment of Alternatives

In this section, we review options for removing or lessening the restrictions on competition together with an assessment of their benefits and costs. The options are:

- * Remove the current restrictions on entry to operate in the club keno market: or
- * Change the restriction limiting club keno to EGM venues

The alternative options will consider the restrictions together. We note that the binding constraint is the restriction on type of venue. Even if the restriction on who may supply club keno were lessened, the EGM venue restriction means that the only practical operators are the present incumbents.

4.1 Alternative option 1. Remove both restrictions.

This option proposes that there would be no restriction on who may operate club keno or where it may be played (other than the usual restrictions on any business activity in Victoria). Consideration of this option is useful, in that it will help highlight any critical and necessary features of any level of regulatory intervention in the operation of club keno.

Benefits of removal of both restrictions on club keno.

It would be expected that were markets free to supply club keno where they chose, there would be an enhancement of product quality and innovation, together with a competitive discipline on price (ie payout ratio). It would also be expected that the game could be played wherever suppliers calculated there were a sufficient cluster of passing customers. Reliance on product integrity would be through the rivalrous behaviour and reputation of suppliers, backed by general fair trading and consumer protection laws.

Costs of removal of both restrictions on club keno

An unrestricted club keno market could result in greater administrative costs in collecting taxation revenue generated by the game. To the extent that unrestricted entry fragments the market making the pool smaller and less attractive, tax revenues are likely to fall. This however, should be judged against the overall size of taxes from club keno (\$3.4M in 1996-97).

More significantly, the objective of maintaining the integrity of club keno will be difficult to meet through relying on general consumer protection law. In this, and other gambling legislation, the Government guarantees the fairness of the game. It does this through probity standards for operators, approval of game rules, and inspectorial functions to ensure integrity conditions are met. These functions would be difficult to do in an unrestricted market. Additionally, in a market where all consumers, however vulnerable, may play wherever club keno is offered, the objective of limiting the social costs of playing club keno might be difficult to meet.

4.2 Assessment of alternative 1.

The considerations above points to the government's critical role as a regulator in the gambling industry. From a community benefit perspective, removal of all competitive restrictions do not appear to meet community expectations. As the Review¹⁰ pointed out, regulatory intervention will help address community concerns because:

First, it is easier to supervise and control a small number of operators. Second, while opportunities for gambling are widely available in Victoria, there are still some restrictions on supply and there is scope to wind that supply back if, for example, evidence comes to hand that the social costs of gambling are unsupportable. Third, a restricted number creates a licence rent, which can be taxed deliberately to secure funds¹¹ to conduct research into problem gambling.

We conclude from the examination of this alternative that the removal of all competitive restrictions is not consistent with achieving the objectives of club keno legislation.

4.3 Guiding premises for lessening restrictions on competition.

Before outlining and discussing other alternatives, it is useful to outline guiding premises for deciding the level of government intervention in club keno and other gambling markets. In this way, even where there is a strong case for government regulation of markets to meet objectives, they can proceed on an internally consistent and transparent way.

The premises outlined below are consistent with the guiding legislative principle adopted for all legislative reviews under National Competition Policy, namely:

Legislation should not restrict competition unless it can be demonstrated that:

*the benefits of the restriction to the community as a whole outweigh the costs; and
the objective of the legislation can only be achieved by restricting competition.*

Thus the premises outlined below are on the basis that there is a presumption in favour of competition. The premises are:

- Because of the intertwined nature of integrity and social policy objectives in regulation of the gambling industry, there is a presumption that government will choose to regulate it. In club keno, as in other gambling legislation, this regulation will set conditions for suppliers, as well as for the venues for playing.

¹⁰ Review *op cit* p 129

¹¹ The review panel notes that tax revenues from club keno do not, in fact, specifically fund research into problem gambling.

- This regulation, like other forms of economic regulation should be directed to the viability of the *industry*, rather than a commitment to the viability of individual participants to it. In other words, existing suppliers should not expect that new gambling products or extension of existing products will necessarily be allocated to them. The government will, of course, meet contractual agreements and obligations now in place.
- Licence design should avoid creating inappropriate incumbency advantages that will preclude later competition. The process for gaining licences should be contestable.
- In principle, exclusive gambling licences should be avoided, that is the licence should be granted to those who pass probity checks. Where licence exclusivity is granted, government is then in the role (inappropriately) of ensuring supplier viability. Making the market contestable will assist in capturing elements of product and market dynamics.
- The government may decide that licence exclusivity, despite its shortcomings, is preferred where there are either large initial licence fees and/or heavy provider capital investments (such as a casino). In these cases, licences should be contestable and time limited. In the case of club keno, neither condition (high initial fee and/or heavy provider capital investment) applies. An exclusive licence is therefore not warranted for club keno.
- Where there are restrictions on locations for playing club keno, designed to meet social objectives, these should be re-examined against the particular risks associated with that product. Such consideration might include the game's propensity to encourage problem gambling, the growth rate of expenditures on the gambling product and ways of excluding minors.

4.4. Options for lessening competitive restrictions

There are three possible other sets of alternatives for lessening competitive restrictions. Each is described in the table below:

Club Keno
Alternatives for regulatory restrictions

	<i>Restriction on venue for club keno</i>	<i>Restriction on supplier of club keno</i>	<i>COMMENT</i>
Option A	Keep restriction to gaming venues	Allow more suppliers	<i>This option would be unworkable as potential suppliers would be unable to access gaming venues. Not preferred.</i>
Option B	Widen range of venues	Current suppliers only	<i>Adoption of this option widens availability, but gives it only to existing suppliers. Not preferred.</i>
Option C	Widen range of venues	Allow more suppliers	<i>This option introduces potential new suppliers to a contestable market. Preferred</i>

Option A, which maintains the current restrictions on locations for playing club keno, but allows more suppliers, was rejected as impractical. Because the two existing suppliers also supply all other gaming machines at gaming venues, it is unlikely that any potential competitor could enter those arrangements.

Option B, which would keep the current suppliers, but lessen the restriction on where club keno would be played, was also rejected. This option would act to give the existing incumbents a further advantage in the gambling markets, by extending their exclusive scope of action.

Option C, to lessen both restrictions is discussed and adopted as the preferred option below. In consideration of this option, the further question arose - should potential suppliers compete for an exclusive licence, or should licences be available to all potential entrants who could satisfy probity criteria? Following the analysis in the previous section, the review panel noted that licence exclusivity was not warranted for club keno. There might be some volatility as a more competitive market established network and game advantage. However, it appeared difficult to establish why the government might select exclusive keno suppliers. There appears to be little tax revenue at stake, and there is no apparent public interest in guaranteeing viability to an exclusive licensee. Further, unlike other gambling products (eg the casino), there

are not large capital investments at stake. The preferred option therefore supports lessening both current legislative restrictions, but without licence exclusivity.

4.5 Alternative 2. (preferred option). Lessen competitive restrictions both on operators of and places where club keno could be played.

This option proposes that government considers a new licence design for club keno, with the aim of injecting some competition for licences to operate club keno. Further, it proposes that this is accompanied by a widening of venues at which club keno may be played. The review panel notes that the current two suppliers support liberalisation of venue.

In particular, in this alternative:

- The permissible venues for club keno would be liberalised. Two options that the government might consider are extension of club keno operations to any club or hotel in Victoria, or, sale through retail outlets.
- Licences to supply club keno would be conditional on meeting probity requirements and would not be exclusive.. There should be flexibility in the 'rules of the game' to allow for bids to propose new game rules.
- The Act would be altered to remove the current restrictions and reflect the new licence and venue arrangements.

Timing of implementation

It is beyond the brief of this review to specify the detail of revised gaming arrangements. Rather, in outlining this alternative, the review panel suggests the parameters under which a less restrictive alternative might be developed. Moreover, these proposals and the review generally does not specify an implementation schedule for the government to adopt. In this case, implementation of any changes may be considered together with other changes to gambling legislation.

Expected benefits of alternative 2.

The expected benefits of revised arrangements are likely to include: a greater incentive for club keno suppliers, through contestability, to innovate and differentiate the club keno product for the benefit of consumers. The wider availability of club keno would allow greater player choice. While the decision to widen available venues for playing club keno is for Government, the review panel notes that if club keno were available in all clubs and hotels, access to minors would still be limited. In this alternative, the government continues to controls the probity requirement of suppliers and the conditions under which club keno is played, thus aiding the integrity objective in legislation.

Expected costs of alternative proposing lesser restrictions on competition

Widening the supplier field (and the possibility for innovations in club keno) may lead to a volatile (or falling) tax revenue base. It is unknown how contestable a club keno market is until tested and it may result in complete market exit from the game. Widening the permissible venues for playing club keno might increase the adverse social costs of gambling as a whole (since it would be more available).

4.6 Assessment of alternative 2.

On balance, the review panel judged that the objectives of club keno legislation could be achieved through adopting this less restrictive alternative. The objective of **integrity of the game through specifying the conditions under which club keno is played** would be met through existing regulatory/inspectorial functions. On the **taxation objective**, it appears that the proposed changes might engender some volatility in the game and therefore in tax flows. However, to the extent that club keno would have the potential to become more popular through altered rules and through wider availability, there is increased potential for taxation flows. The objective of **limiting the social costs of this type of gaming** appears the hardest to assess. It is not known under the present arrangements if this objective is met. To the extent that venue restrictions may be important in limiting social costs, liberalising access only as far as clubs and hotels may assist in meeting this objective.

4.7 Findings

Complete removal of both restrictions in club keno is inconsistent with achieving the objectives of the club keno legislation. There appears to be a strong case for retaining a degree of government regulation of club keno.

Internally consistent regulatory design should be based on articulated premises consistent with the pro-competitive thrust of National Competition Policy. The premises are:

- *Because of the intertwined nature of integrity and social policy objectives in regulation of the gambling industry, there is a presumption that government will choose to regulate it. In club keno, as in other gambling legislation, this regulation will set conditions for suppliers, as well as for the venues for playing.*
- *This regulation, like other forms of economic regulation should be directed to the viability of the industry, rather than a commitment to the viability of individual participants to it. In other words, existing suppliers should not expect that new gambling products or extension of existing products will necessarily be allocated to them. The government will, of course, meet contractual agreements and obligations now in place.*

- *Licence design should avoid creating inappropriate incumbency advantages that will preclude later competition. The process for gaining licences should be contestable.*
- *In principle exclusive gambling licences should be avoided, that is the licence should be granted to those who pass probity checks. Where licence exclusivity is granted, government is then in the role (inappropriately) of ensuring supplier viability. Making the market contestable will assist in capturing elements of product and market dynamics.*
- *The government may decide that licence exclusivity, despite its shortcomings, is preferred where there are either large initial licence fees and/or heavy provider capital investments (such as a casino). In these cases, licences should be contestable and time limited. In the case of club keno, neither condition (high initial fee and/or heavy provider capital investment) applies. An exclusive licence is therefore not warranted for club keno.*
- *Where there are restrictions on locations for playing club keno, designed to meet social objectives, these should be re-examined against the particular risks associated with that product. Such consideration might include the game's propensity to encourage problem gambling, the growth rate of expenditures on the gambling product and ways of excluding minors.*

The preferred option for club keno regulation is to open licences to those passing probity requirements and to widen the venues at which club keno may be played. Widening the range of venues is necessary before contestability is introduced amongst suppliers. If venues are not extended, no potential supplier would be able to enter the existing gaming venue arrangement.

The review panel judged that the three main objectives of club keno legislation would be met through adopting the preferred option.

On balance the benefits of wider supply (subject to probity) leading to greater market innovation and a greater range of venues were seen to outweigh the risks of lessening the restrictions. It was difficult to assess the risk (if any) of the social costs of widening the permissible venues for club keno. The review panel could not assess the risk to the (small) tax revenue base.

5 RECOMMENDATIONS

From our examination of the *Club Keno Act 1993*, we conclude that the objective of the Act may be met by lessening the existing restrictions on competition. Considering the premises outlined in the 'findings' section above, we therefore recommend:

1. **The permissible venues for club keno should be liberalised. Two options that the government might consider are extension of club keno operations to any club or hotel in Victoria, or, sale through retail outlets.**
2. **The government should make available licences to supply club keno to those who pass the probity checks. Any pooling should emerge through the market (ie those with strong networks and attractive games). In club keno, there should be no exclusive licences.**
3. **There should be flexibility in the 'rules of the game' to allow for potential competitors to propose new game rules.**
4. **In view of the small relative size of club keno, and other legislative reviews of gambling regulation to be conducted, the government may wish to combine implementation with other changes to gambling legislation.**

ATTACHMENT 1

Consultation during the Act's review

The review panel acknowledges the assistance given by the following during consultation:

Tattersall's (Estate of the late George Adams)

Tabcorp Holdings Ltd

Victorian Casino and Gaming Authority