

Gaming Machine Entitlements Approved Trading System

Consultation Paper

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Glossary

2004 Amendments	Amendments to the <i>Gaming Machines Act 1992</i> made by the <i>Gaming Machines (Miscellaneous) Amendment Act 2004</i>
2004 Amendments Inquiry	<i>2004 Amendments Inquiry Report</i> by the IGA and provided to the Minister for Gambling on 12 September 2007.
2008 Consultation	Consultation paper on the draft amendments to the <i>Gaming Machines Act 1992</i> released on 22 September 2008.
Commissioner	Liquor and Gambling Commissioner
Club One	Holder of the special club licence pursuant to section 24A of the <i>Gaming Machines Act 1992</i>
Final Policy Position Paper	Amendments to the <i>Gaming Machines Act 1992</i> – Final Policy Position Released July 2010
IGA	Independent Gambling Authority
OLGC	Office of the Liquor and Gambling Commissioner

1 Executive summary

1.1 Market Design Objectives

In determining the rules for the new Approved Trading System, the South Australian Government will take account of the overarching policy objective of “*removing obstacles to trade in order to accelerate the reduction in the number of gaming machine entitlements*”. Supporting market design objectives that will also be considered are that the Approved Trading System should be:

- low-risk
- fair
- simple
- low-cost
- transparent
- voluntary

In this paper, the overarching objective and the supporting design objectives have been used to assess the various options and proposals. The objectives are further discussed in section 3.

1.2 Common Market Features

This paper examines a range of proposals put forward in submissions responding to the consultation paper on the draft amendments to the *Gaming Machines Act 1992* released on 22 September 2008. These proposals would apply regardless of which market model was selected for the Approved Trading System.

This paper proposes that the following arrangements should apply:

- the existing forfeiture rules for the Approved Trading System be retained;
- the Approved Trading System will not differentiate between club and hotel buyers/sellers;
- the Approved Trading System will not treat differently venues subject to insolvency arrangements;
- the Approved Trading System will not treat differently venues based on their geographic location; and
- no “use it or lose it” provisions will be established for the Approved Trading System and the current regulation 15 will be repealed;

The reasoning underlying these proposed arrangements is set out in section 4 of this consultation paper.

1.3 Preferred Approved Trading System model

This paper assesses four possible market models for the Approved Trading System. The options are:

- **Option 1: Bilateral Trade** – where the transaction to transfer gaming machine entitlements is direct between the buyer and seller.
- **Option 2: Notice Board Trade** – where the transaction to transfer gaming machine entitlements is direct between the buyer and seller, but is facilitated by a

'notice board', operated by the Office of the Liquor and Gambling Commissioner (OLGC), where buyers and sellers can advertise.

- **Option 3: Pooled Trading** – a trading round system operated by the OLGC where the price received by sellers is the average price of the pool of gaming machine entitlements sold.
- **Option 4: Periodic Trading** – a trading round system operated by the OLGC where the market equilibrium price is determined by buy and sell bids.

The preferred model for the Approved Trading System is the Periodic Trading model. It best achieves the overarching objective and the supporting market design objectives. The summary of the evaluation is provided in the table below.

Summary of Market Models

		Bilateral Trade	Pooled	Periodic	Notice Board
Criteria	low-risk	X	X	√	X
	fair	X	X	√	X
	simple	X	X	√	X
	low-cost	X	√	√	√
	transparent	X	√	√	X
	voluntary	√	√	√	√

It is proposed that the periodic trades be conducted at least two times a year and that all gaming machine entitlements transactions from hotels be conducted through the Approved Trading System. Clubs will have access to the Approved Trading System and the existing gaming machine entitlement transfer provisions in the *Gaming Machines Act 1992*.

The analysis of market models for the Approved Trading System is set out in section 5.

1.4 Market Rules

The Regulations need to set out detailed market rules for the Approved Trading System to be implemented by the OLGC. These rules need to be flexible enough to handle a number of contingencies.

The rules address the following matters:

- eligibility to participate;
- setting up the market by creating bid stacks;
- applying forfeiture;
- determining provisional market outcomes;
- determining final market outcomes; and
- a range of market scenarios.

In terms of eligibility to participate it is proposed that buyers must:

- have sufficient approval to operate the total number of gaming machines under the *Gaming Machines Act 1992* for which they are seeking to buy gaming machine entitlements (i.e. their current number of gaming machine entitlements plus the buy bids does not exceed their approved maximum number of gaming machines);

- identify the maximum price that they are willing to pay for a gaming machine entitlement; and
- pay the prescribed deposit.

In terms of eligibility to participate it is proposed that sellers must:

- demonstrate that the licensee has the ability to sell its gaming machine entitlements unencumbered; and
- identify the minimum price at which they are willing to sell a gaming machine entitlement.

More information about qualifying for participation in the Approved Trading System is provided in section 6.

Once the buy and sell bids are received the OLGC must:

- create buy and sell bid stacks:
 - the sell bid stack is created by ordering the sell bids from lowest price to highest price. If there are bids of equal price then the position in the bid stack at that price is determined by random allocation.
 - the buy bid stack is created by ordering the buy bids from highest price to lowest price. If there are bids of equal price then the position in the bid stack at that price is determined by random allocation.
- remove forfeited gaming machine entitlements from the pool and adjust the sell bid stack prices and quantities to take account of forfeiture. The maximum price that a seller is willing to receive must be multiplied by one and one third ($1\frac{1}{3}$). The entitlement quantity associated with each price must be multiplied by 0.75.
- determine the provisional market outcome by:
 - determining the quantity demanded by identifying the position in the bid stack where the price in the buyers bid stack is minimised and is greater than or equal to the adjusted price in the sellers bid stack.
 - determining the market equilibrium price at the quantity demanded. The market equilibrium price is either the buy price/the adjusted sell price when they are equal or, if the buy price is greater than the adjusted sell price, then it is determined by taking the midpoint between the buy price and the adjusted sell price. The midpoint formula is $(p_b + p_s)/2$, where p_b represents the buy price in the bid stack to buy and p_s represents the sell price in the bid stack to sell.
- apply special rules in certain circumstances to determine a provisional market outcome. Those rules are:
 - where the adjusted sell prices of offers to sell are greater than all of the prices of offers to buy, the Commissioner will report nil trade. A further trading round may be announced at that time.
 - where all of the prices of offers to buy are greater than all of the adjusted sell prices of the offers to sell, then all of the sell offers are successful and all of the buy offers up to the total of entitlements available to sell are also successful. The market price is determined by taking the midpoint of prices in the bid stack between the highest offer to sell and corresponding bid stack price to buy.

- determine a final market outcome:
 - if a buy transaction has not been completed then the last gaming machine entitlement identified as successful at the provisional market outcome in the sale bid stack will be treated in one of the following ways:
 - if there are no offers to buy that satisfy the offers for sale (i.e. the buy price is greater than or equal to the sell price), then the last gaming machine entitlement identified as successful at the provisional market outcome in the sale bid stack is not sold and is returned to the licensee.
 - if there are more offers to buy that satisfy the offers for sale (i.e. the buy price is greater than or equal to the sell price) then that bid is identified as successful and the licensee notified.

Examples of how the market rules work are provided in section 7.

2 Introduction

The *Gaming Machines Act 1992* regulates the supply and operation of gaming machines in South Australian club and hotel venues.

Sitting within the *Gaming Machine Regulations 2005* is the Approved Trading System that describes the process under which gaming machine entitlements are traded in South Australia.

The purpose of this consultation paper is to:

- describe the South Australian Government's policy approach to the creation of a new Approved Trading System for gaming machine entitlements for an environment where the price is determined by the market; and
- seek comment from interested parties on the practical implementation of the proposed Approved Trading System.

2.1 Background

The South Australian Government accepted the recommendation contained in the Independent Gambling Authority's *2003 Inquiry into the Management of Gaming Machine Numbers* that there be a 20% (3,000) reduction in the number of gaming machines operating in South Australia.

In 2004 the Parliament passed a series of amendments to the *Gaming Machines Act 1992* in response to the IGA's recommendations. The *Gaming Machines (Miscellaneous) Amendment Act 2004* made provision for trading of entitlements under an Approved Trading System and mandated the reduction in gaming machine numbers through amendments to the *Gaming Machines Act 1992*.

The current Approved Trading System is described in detail in Regulations made under the principal legislation, primarily Regulation 14 of the *Gaming Machines Regulations 2005*.

The *Gaming Machines (Miscellaneous) Amendment Act 2004* created the concept of establishing gaming machine entitlements and created 12,950 gaming machine entitlements on 1 February 2005. This achieved the first reduction of 2,168 gaming machine entitlements or 72% of the 3,000-reduction target recommended by the IGA.

The remaining 832 gaming machine entitlements were to be removed through forfeiture requirements of the current Approved Trading System. Under the current Approved Trading System, entitlements had a fixed price of \$50,000. One out of every four hotel gaming machine entitlements traded through the current Approved Trading System would be forfeited.

The first gaming machine entitlement trading round was held on 11 May 2005. Two subsequent trading rounds were held on 21 September 2005 and 16 April 2007. After these three trading rounds, a further 782 gaming entitlements are still required to be forfeited before the 3,000 target is achieved.

The IGA, in its 2004 Amendments Inquiry report, recommended, among other things, the removal of the fixed purchase price of \$50,000 per gaming machine entitlement and the implementation of a market model. The Government has adopted that recommendation and it has been included in the *Gaming Machines (Miscellaneous) Amendment Bill 2010*.

The purpose of this consultation paper is to consult on the market model and associated rules that could be included in the new Approved Trading System to support a market-set price for gaming machine entitlements.

2.2 Structure of this Consultation Paper

The remainder of this consultation paper will address the following:

- market design objectives;
- common market features;
- Approved Trading System options;
- before the trading round; and
- conduct of the trading round.

2.3 Next Steps

The proposed next steps, subject to the *Gaming Machines (Miscellaneous) Amendment Bill 2010* being enacted by Parliament, are:

- receiving submissions on this consultation paper;
- preparing Regulations based on the proposal contained in this consultation paper and submissions received;
- further consultation with industry and the community sector on the detailed market rules through the Responsible Gambling Working Party. It is anticipated that a sub-committee will be established to work through the market rules in details to ensure that interests of all parties are met;
- making the Regulations to implement the new Approved Trading System by early 2011; and
- commencing the first trading round under the new Approved Trading System in the first half of 2011.

Submissions that address the practical implementation of the recommended market model and its associated rules as described in this paper should be sent by email or post by no later than **Friday 3 September 2010** to:

e-mail: gamblingpolicy@sa.gov.au

post: Gambling Policy
Department of Treasury and Finance
GPO Box 1045
Adelaide SA 5001

Submissions received will be placed on the Department of Treasury and Finance website and maybe quoted in subsequent policy and/or consultation papers.

Additional copies of the consultation paper can be downloaded from:

<http://www.treasury.sa.gov.au/gamblingpolicy>

3 Market Design Objectives

3.1 Introduction

In assessing the options for a new Approved Trading System, this Consultation Paper will apply the overarching objective of *removing obstacles to trade in order to accelerate the reduction in the number of gaming machine entitlements*.

In applying this overarching objective, consideration will be given to the market design objectives identified in the Final Policy Position Paper. They are that the market model be:

- low-risk
- fair
- simple
- low-cost
- transparent
- voluntary

This section will outline in more detail the market design objectives. Section 4 will apply the market design objectives to common features to be included in any market design. Section 5 assesses the alternative market models to determine the preferred model for application to the South Australian market for gaming machine entitlements.

3.1.1 Low-risk

Participating in any market involves risk to both buyers and sellers.

The Approved Trading System should be designed in such a way that minimises risk to both the buyers and sellers of gaming machine entitlements.

Buyers and sellers should be confident that once a gaming machine entitlement has been allocated through the market the sale process will be completed and the transfer of the entitlement ownership will occur.

Buyers and sellers should be able to confidently participate in the market.

The Approved Trading System should be designed in a way to minimise the risk to the South Australian Government.

3.1.2 Fair

The Approved Trading System should not be biased towards buyers or sellers, or towards large venues or small venues, or towards regional or city venues, or towards clubs or hotels.

Buyers and sellers should have equal access to the market and feel confident that their situation does not result in a price being paid or received that is significantly at variance to other market participants.

The Approved Trading System should significantly limit opportunity for buyers to place pressure on prospective sellers.

Ability to participate in the market should not be limited by regional location or by venue type.

3.1.3 Simple

This is related to the low-risk objective.

The Approved Trading System and how to participate should be easy to understand for both buyers and sellers. Information should be readily available.

The rules of the Approved Trading System should not unduly limit participation by buyers and sellers.

3.1.4 Low-cost

The Approved Trading System should minimise the cost to buyers and sellers associated with participating.

The cost associated with participating in the Approved Trading System can be broken down into search costs and transaction costs.

Search costs are those costs incurred by a buyer/seller to find a seller(s)/buyer(s) in order to complete a transaction.

Transaction costs are those costs incurred by a buyer/seller once the other party is found in order to complete the legal transfer of the gaming machine entitlements.

3.1.5 Transparent

The Approved Trading System should clearly establish a market value for gaming machine entitlements.

A market value is important to all gaming venues. It allows them to make informed decisions about whether to continue to operate a gaming venue or to exit the industry. A clear market value will help create confidence in the gaming machine entitlements as an asset which could be included as part of collateral in business financing arrangements.

The conduct of the Approved Trading System should be transparent so that market participants and potential market participants have confidence in the system and its outcomes.

3.1.6 Voluntary

The decision to trade in the Approved Trading System should be on a voluntary basis with agreement amongst all those who have an interest in the gaming machine entitlement. The decision of venues to buy or sell gaming machine entitlements should not be unduly constrained by the Approved Trading System.

4 Common Market Features

4.1 Introduction

This section will address features identified in submissions responding to the consultation paper on the draft amendments to the *Gaming Machines Act 1992* released on 22 September 2008 (2008 Consultation). These features could be implemented regardless of the market model adopted for the Approved Trading System.

The common features that could be included in any Approved Trading System and discussed further in this section are:

- forfeiture;
- club priority;
- insolvency;
- geographic restrictions; and
- ‘use it or lose it’ gaming machine entitlements.

4.2 Forfeiture

Under the current trading system arrangements, gaming machine entitlements are forfeited under the following rules:

- One in every four hotel entitlements offered for sale shall be forfeited to the State; and
- One in every four club entitlements offered for sale shall be forfeited to Club One.

The purpose of the forfeiture rule is to work towards the 3,000 gaming machine entitlement reduction target and to support reform of the club sector through Club One.

In their submission on the 2008 Consultation, the Collaborating Community Agencies recommended that:

We consider that these comments and the recommendation are still valid and so recommend that the draft legislation amend the rate of removal of EGM entitlements through trading to one entitlement forgone for every three traded.

This recommendation is based on analysis included in their submission to the IGA’s 2004 Amendments Inquiry. That submission stated:

The current process requires one machine entitlement being forfeited for each four being purchased. We note that in New South Wales, one machine entitlement is forfeited for each 3 purchased. The following table shows the level of trade required in order to meet the machine reduction target of 798 machines, using different rates of loss through trade.

Entitlement Trade to Achieve 798 EGM Entitlement Reduction.

<i>Entitlement loss rate</i>	<i>1 in 2</i>	<i>1 in 3</i>	<i>1 in 4</i>	<i>1 in 5</i>
<i>Trades to secure EGM loss outcome</i>	<i>1596</i>	<i>2394</i>	<i>3193</i>	<i>3990</i>
<i>EGM entitlements relocated</i>	<i>798</i>	<i>1596</i>	<i>2394</i>	<i>3192</i>
<i>EGM entitlements removed</i>	<i>798</i>	<i>798</i>	<i>798</i>	<i>798</i>

We observe that a reduction rate of one in three with an associated entitlement demand of 1596 entitlements, is closer to entitlement demand in South Australia of 1349 entitlements, through rounds one and two. While there are many other factors associated with the trading model, we suggest that this reduction rate is more realistic for South Australia to achieve the desired outcome.

Similarly, Club One's submission stated:

Club One does not believe the proposals will result in the reduction of the GMEs by the amount sought by government. It is the understanding of Club One that many of the potential machines are in small hotels in small numbers. They are the possession of the landlord who would see the GME as worth more to the total lease or as a mortgage asset rather than as an object for sale.

There is also a numbers consideration, at 1 in 4 being culled; over 3,200 sales will be required. The experience of Club One, which has been in the marketplace for over 18 months, predicts that this volume of trade is not feasible, as stated; most would rather hold the appreciating asset and access capital rather than sell into the marketplace. This is particularly so for landlords of small hotels who use the GME asset as a means of extracting greater rents from leaseholders.

It is not possible to accurately predict demand for gaming machine entitlements and while the previous three trading rounds provide some indicators it is unlikely to be effective in predicting longer-term market outcomes.

Demand is influenced by many factors, one of which is price. The previous three trading rounds were based on a fixed price of \$50,000. Future trading rounds will not have a fixed price. The impact of a higher forfeiture rate is that the price for gaming machine entitlements will need to significantly increase in order to achieve the same level of compensation to the sellers. This will have an impact on demand and with the information available it is not possible to conclude whether this will result in an increase or decrease in the number of entitlements removed.

Given the number of other changes and a lack of strong evidence to change the forfeiture rate, it is proposed to maintain the current one in four forfeiture rules that apply to the Approved Trading System.

Clubs SA suggested that:

the remaining 782 GMEs be systematically removed from the Hotel industry which currently holds more than seven times the total amount of GMEs in Clubs. For the Government to effectively reduce the number of GMEs in this State, the obvious target should be that sector where most machines are housed and which can better afford to absorb such a reduction. A loss of 782 GMEs from the Hotel industry would represent less than 7% of its current total holdings. By contrast, this amount would represent in excess of 50% of total Club holdings – which is clearly an untenable option.

While it is possible to increase the rate of acceleration by changing the forfeiture rules so that all of entitlements forfeited as part of the trading system are extinguished, the Government is committed to a strong club sector. It is proposed to maintain the forfeiture rule that provides to Club One all of the entitlements forfeited by clubs trading in the Approved Trading System.

Outcome

It is proposed to retain the existing forfeiture rules for the Approved Trading System.

4.3 Club Priority

The Club sector is concerned about the impact of the Approved Trading System on clubs. Clubs SA in its submission stated:

Clubs are not for profit entities that return net surpluses to their communities to provide improved benefits and much needed facilities for members and residents in locales across South Australia. Clubs also provide valuable funding and housing for the encouragement of sports and community activities that could not be otherwise funded by Government.

Given the gross imbalance of gaming operations between Clubs and Hotels, it is highly likely that any GMEs put up for sale from the Club industry in the next trading round would be purchased by Hotels. The impact of this trading system would therefore effectively deliver even more concentrated ownership of GMEs to Hotels at the expense of the not for profit Club industry. This would seriously affect ongoing cashflow in Clubs and have profound, negative social affect across our communities resulting from loss of facilities and amenities.

Concessions in the *Gaming Machines Act 1992* ensure that clubs are well placed to operate in an Approved Trading System without a fixed price. Measures that provide support to the club sector include:

- a concessional tax rate of up to 10 percentage points less than hotels (section 72);
- additional flexibility regarding the ability to transfer gaming machine entitlements (section 27B);
- establishment of the special club licence (Club One) (section 24A); and
- special forfeiture rules to provide entitlements to Club One at no cost.

Further, Clubs SA raised concern about long-term income for the club sector. Clubs SA in its submission stated:

The proposed trading model offers no long-term income protection for the Club industry and will more likely serve to weaken it as a whole as a result of losing GMEs (refer Attachment 1 from the Office of Liquor & Gambling Commissioner Annual Report 2006-07). According to the Commissioner's Annual Report 2006-07, in the period 2003-2007, Clubs lost 16% of their gaming venues compared to only 2.6% for Hotels. The proposed trading model will put even greater pressure on smaller, volunteer based clubs to sell GMEs to the Hotel industry. Hoteliers can more easily afford to convert these newly acquired GMEs to the latest technological games and house them in top performing venues, thereby generating increased NGR for the Hotel industry only. Patrons follow games they enjoy most and this trend will undoubtedly continue.

Similarly, Anglicare SA stated:

Notwithstanding the benefits associated with an overall reduction in venues, there are some potential downsides in the loss of some smaller operators where this involves community not for profit clubs. Anglicare SA would like to see provisions maintained so that such operators will not be disadvantaged by the introduction of this Amendment, and the proportion of the market share they manage be sustained in the distribution of licences in South Australia.

A fundamental market design objective for the Approved Trading System is that it must be voluntary. That is decisions by individual clubs (and for that matter hotels) must not be unduly constrained by the Approved Trading System. There is absolutely no compulsion for any club to sell an entitlement through the Approved Trading System.

Following the voluntary market design objective, there should be nothing in the Approved Trading system preventing a club from receiving income through the asset of

a gaming machine entitlement. Equally, following the voluntary market design objective there should be nothing preventing a club from purchasing additional entitlements.

It should be noted that the concessional tax rate ensures that clubs receive a greater share of the revenue from a gaming machine. This leaves clubs well placed to buy entitlements through an Approved Trading System.

Clubs SA in its submission recommended that:

Clubs be quarantined from any future trading rounds in order to preserve this revenue stream that is the lifeblood of the Club industry, thereby enabling it to deliver a myriad of social and economic benefits.

This recommendation is inconsistent with the voluntary market design objective. It will deny individual clubs the ability to make voluntary decisions about their future in the gaming industry.

Further, Clubs SA in its submission recommended that:

any GMEs put up for future trade by Clubs be first offered to other Clubs for purchase at a price nominated by the Authority. This would create a fairer playing field for trade of GMEs within the Club industry to ensure that Clubs are not expected to compete against the might of a Woolworths or any other powerful commercial entity. Since its inception, Club One has successfully provided enough incentive to a significant number of Clubs to acquire under-utilised GMEs for the benefit of both parties and the Club industry generally.

Similarly, Club One in its submission recommended that:

Finally, should the government be so moved as to have a managed market, and thereby set a price, Club One would seek to have the first option to buy Club GMEs at this price so that the principle of maintaining GMEs within the Club sector can be maintained.

These recommendations are inconsistent with the simplicity and fair market design objectives.

In relation to fairness, it treats clubs that seek to sell entitlements differently and denies them the opportunity to receive a fair market price for the entitlement as the proposal assumes a price fixed by “the Authority”.

In relation to simplicity, it makes the Approved Trading System more complicated and difficult to understand and operate.

The impact of this recommendation is to segregate the market for entitlements and the impact is that the market value for club entitlements will be lower. This will impact all clubs. Those clubs that wish to sell will not receive as much. Those clubs that wish to retain entitlements will also be affected, the value of the entitlements they hold will be reduced and their ability to seek finance against these entitlements will be reduced.

Gaming machine entitlements represent an essential asset for any business or organisation that wants to operate as a gaming venue. Decisions about whether to buy or sell an asset should be determined based on predicted revenue flows. Clubs are well placed to participate in the Approved Trading System because, all other things being equal, the concessional tax rate means that a gaming machine entitlement will provide a higher net revenue flow to clubs than to hotels.

Outcome

It is proposed that the Approved Trading System will not differentiate between club and hotel buyers/sellers.

4.4 Insolvency

The Salvation Army suggested in its submission that the Approved Trading System should discount entitlements sold by gaming machine venues that have become insolvent. Specifically the submission from The Salvation Army stated that:

businesses that became insolvent would still receive a fixed price limited to \$50,000 per entitlement in winding up the business and all entitlements of that business would be taken out of circulation altogether. This would encourage businesses that are underperforming to trade earlier rather than leave their trading of entitlements too late to receive market value. This would possibly result in quicker reductions in entitlements due to both mechanisms at work in different cases as outlined above. The question would be who will pay the \$50,000 per entitlement to take the entitlements out of circulation? For example, if a hotel had four gaming machine entitlements and the business became insolvent, the wind up of the business would result in the business receiving a credit of \$200,000 for giving up the entitlements and the entitlements could not then be sold on to any party. The problem of where the \$200,000 comes from could be solved if entitlements had zero value at the point of insolvency and were then forfeited from the whole system in the case of an insolvent business. This would encourage early trading even further than the previous proposal.

If provisions like this were included in the Approved Trading System it is not anticipated that they would be called on often. The provisions however would be inconsistent with the simplicity and fair market design objectives.

Further, it is possible that these provisions may be inconsistent with federal law in relation to insolvency.

Outcome

It is proposed that the Approved Trading System will not treat differently venues subject to insolvency arrangements.

4.5 Geographic Restrictions

Anglicare SA suggested that the Approved Trading System should include some geographic-based restrictions. Specifically the submission from Anglicare SA stated:

a resulting increase in the concentration of entitlements in some geographic areas is of concern. In Anglicare's experience of delivering Help Services to people experiencing problems with gambling, the ready accessibility of machines, particularly in larger venues where queuing for machines is less common, facilitates problem gambling behaviour in these, and surrounding, areas. In order to guard against such an outcome Anglicare SA would like to see the introduction of parallel strategies to increase regulation on the geographic concentration of gambling machine entitlements. Such strategies would seek to ensure that higher numbers of entitlements are not shared amongst a few larger venues situated within local proximity to each other, particularly in low socio demographic profile regions.

The proposal is inconsistent with the simple and fair market design objectives. Regional restrictions would significantly complicate the Approved Trading System and would unduly discourage potential buyers and sellers. However, proposals contained in the *Gaming Machines (Miscellaneous) Amendment Bill 2010* already work to limit the establishment of new gaming machine venues or expand existing venues where it

“would be contrary to the public interest on the ground of the likely social effect on the local community and, in particular, the likely effect on problem gambling within the local community.”

Specifically this is addressed by the proposed new Social Effect Test certificate contained in the proposed new section 17B and the new provisions in relation to the variation of licence conditions contained in the new section 27AA. Under the new section 27AA, venues that seek to expand the maximum number of gaming machines they can operate may be required by the Commissioner to satisfy the Social Effect Test.

Further information about the Social Effect Test is provided in sections 3 and 9 of the Final Policy Position paper.

Outcome

It is proposed that the Approved Trading System will not treat differently venues based on their geographic location.

4.6 Use It or Lose It Gaming Machine Entitlements

ALH Group suggested in its submission that:

any approved trading system of gaming machine entitlements includes a requirement if successful bidders are unable to install entitlements within six months of trade that they will go back into the auction pool where sellers receive a sale price less a significant commission.

The use it or lose it rule is not required as an incentive to ensure that entitlements are effectively used by entitlement holders. The establishment of a market price is sufficient. It is not appropriate for a regulation to arbitrarily extinguish an entitlement that a venue has paid a market price.

Outcome

No use it or lose it provisions are proposed for the Approved Trading System. The current regulation 15 will be removed.

5 Approved Trading System Options

5.1 Introduction

This section presents four possible market models that can be implemented as the Approved Trading System. Each model option will be described and assessed against market design objectives in section 3. A preferred model for the Approved Trading System is then identified.

The section will assess the following market models:

- Bilateral Trade
- Notice Board Trade
- Pooled Trade
- Periodic Trade

A number of specific issues highlighted in submissions from the 2008 Consultation that are relevant to the recommended market model will also be discussed.

5.2 Option 1: Bilateral Trade

The Bilateral Trading model does not involve the establishment of any formal market place in the *Gaming Machine Regulations 2005*. The transaction is direct between the buyer and seller. The process of searching for gaming machine entitlements and preparing and negotiation the commercial documentation is the direct responsibility of the parties to the trade. No formal trading round would occur and there would be no specific trading period.

The *Gaming Machine Regulations 2005* would be limited to the process by which commercial transactions are registered and the formal transfer of the entitlement by the OLGC is effected.

The Bilateral Trading model for gaming machine entitlements has been implemented in New South Wales. Entitlements are traded in blocks of two or three, for each block traded one gaming machine entitlement is forfeited. If adopted in South Australia, gaming machine entitlements would need to be traded in blocks of four with one entitlement from each block to be forfeited.

The submission from Club One supported this market model stating that:

Club One supports an open and free trade system and points to its own efforts in setting up a market process utilising the OLGC. Club One believes that a simple continual sale system would operate to set a value for the GMEs and to encourage an efficient and effective transfer of an asset so it might reach its market potential. Thus Club One does not accept that a new managed trade system should be introduced to effect a GME reduction. If a new trade system is to be introduced it should be for its own merits.

Similarly, the Collaborating Community Agencies (Heads of Christian Churches Gambling Taskforce) supported this market model, their submission stated they would:

accept trading at anytime being undertaken between hotel venues and other hotel venues, or between two or more club venues and these trades being logged with the Independent Gambling Authority for approval and registered with the OLGC.

The assessment of the Bilateral Trading model against the market design objectives is below.

5.2.1 Low-risk

The lack of clear market rules in the Bilateral Trading model imposes additional risk on the market participants seeking to negotiate and complete transactions.

Both the buyer and seller face the risk that a transaction is not completed. The impact of the risk would be the costs associated with negotiation and preparing the commercial contract. This risk may arise for a change in position by the buyer or seller or potentially a third party contesting the commercial contract.

Given the Government is not involved in the bilateral trade there is little risk to Government.

5.2.2 Fair

The Bilateral Trading model favours those participants who have the resources to conduct the costly search and preparation of commercial contracts, as discussed under the low-cost heading. Thus smaller hotels and clubs, or hotels that are not part of a group, may find it difficult to participate as buyers in the market under the Bilateral Trading model. Hotels and clubs seeking to buy or sell less than four entitlements would find it more difficult to participate.

The Bilateral Trading model requires that potential sellers be approached directly by buyers. This may create situations where smaller hotels and clubs may feel pressured to sell or find that multiple buyers are seeking to buy their entitlements.

5.2.3 Simple

The Bilateral Trading model appears to be simple, resulting from a lack of common market rules established in the Regulations. In reality, the lack of rules makes the Bilateral Trading model more complex and more risky because there are not any clear points of reference for buyers and sellers.

The Regulations from a Government perspective are simple and only relate to the formal registration of the trade.

5.2.4 Low-cost

The Bilateral Trading model is likely to involve significant costs to market participants. The search costs for entitlements will be substantial involving the seller (or buyer) potentially searching for other interested parties. Similarly, the flexibility of the Bilateral Trading model suggests that the transaction costs will also be substantial.

5.2.5 Transparent

There is a limited degree of transparency in the Bilateral Trading model. Gaming machine entitlement transactions could remain confidential. The true market value of a gaming machine entitlement may not be available on an on-going basis. However, if such a system were adopted in South Australia the Regulations could require the OLGC to publish all transfers and prices.

5.2.6 Voluntary

Under the Bilateral Trading model all trades are entirely voluntary. As noted under the fair market design objective, there is the potential for buyers to place pressure on sellers due to the direct trade relationship.

Conclusion

The pure version of the Bilateral Trading model is unlikely to exist. The significant risks and high search and transaction costs will inevitably result in private sector solutions. This may include the establishment of:

- broker services. In New South Wales hotel brokers also offer brokerage services for gaming machine entitlements;
- notice boards for buyers and sellers;
- auctions; and
- standardised contractual arrangements.

These are standard market based solutions which will all involve additional costs to market participants. While these market based solutions address cost and risk, it will not address concerns outlined under the fair market objective about the ability for smaller clubs and hotels to participate or the potential for undue pressure to be placed on potential sellers.

Given the inevitability of some intermediary between buyers and sellers under the Bilateral Trading model, it is appropriate to contemplate the form of that intermediary and to ensure that it works in such a way as to address the fair market objective and is applied evenly to all transactions. As a result, the Bilateral Trading model is not recommended. The other three models considered in this section involve the establishment by Regulation of an intermediary between buyers and sellers.

5.3 Option 2: Notice Board Trade

The Notice Board Trading model is closest to the Bilateral Trading model. It seeks to reduce the search costs through the establishment of a 'notice board', run by the OLG, which would advertise gaming machine entitlements available for trade. The remainder of the transaction is the same as the Bilateral Trading Model and as a result gaming machine entitlements would need to be traded in blocks of four with one entitlement from each block forfeited.

5.3.1 Low-risk

The Notice Board Trading model reduces the risk associated with the search for entitlement but does not change the risk profile in relation to the remainder of the transaction when compared to the Bilateral Trading model.

5.3.2 Fair

The Notice Board Trading model makes it easier for smaller clubs and hotels to participate by lowering the cost associated with the search. It does not, however, help hotels and clubs seeking to buy or sell less than four entitlements.

The Notice Board Trading model still involves direct negotiation of contractual arrangements. This may create situations where a smaller hotels and clubs could feel pressured to sell.

5.3.3 Simple

Like the Bilateral Trading model, the Notice Board Trading appears to be simple. In reality, the lack of rules makes the Notice Board Trading system more complex and more risky because there are not any clear points of reference for buyers and sellers. This complexity, compared with the Bilateral Trading model, is reduced because the notice board addresses issues associated with the search costs.

The Regulations from a Government perspective are simple and only relate to the formal registration of the trade.

5.3.4 Low-cost

Compared with the Bilateral Trading model, the Notice Board Trading model substantially reduces the search costs to market participants. However, costs associated with completing the transaction are likely to still be substantial.

5.3.5 Transparent

There is greater transparency in relation to buy and sell offers by virtue of the Notice Board. In relation to completed transactions, there is a limited degree of transparency in the Notice Board Trading model. Gaming machine entitlement transactions could remain confidential. The true market value of a gaming machine entitlement may not be available on an on-going basis. However, if such a system were adopted in South Australia the Regulations would require the OLG to publish all transfers and the associated prices.

5.3.6 Voluntary

Under the Notice Board Trading model all trades are entirely voluntary. As noted under the fair market design objective, there is the potential for buyers to place pressure on sellers due to the direct trade relationship.

Conclusion

The Notice Board Trading model offers an improvement over the Bilateral Trading model in terms of search costs. It does not, however, address the risks and costs associated with completing the transaction. It is likely that market services will develop to address these deficiencies at cost to market participants.

The Notice Board Trading model does not address the concerns identified under the fair market design objective, namely the ability for potential buyers to place pressure on potential sellers. The Notice Board Trading model does not facilitate smaller clubs and hotels participating in the market.

This Notice Board Trading model is not recommended.

5.4 Option 3: Pooled Trade

Under the Pooled Trading model, buyers place bids in the trading round indicating the number of entitlements they are wishing to buy and the maximum price they are willing to pay. Sellers indicate the number of entitlements they are wishing to sell. Under this model the price received by sellers is the “average price” of the pool of gaming machine entitlements sold.

No submission called for this market model to be adopted.

5.4.1 Low-risk

Risk is reduced through the establishment of clear market rules that are applied by an impartial intermediary.

Risk in relation to price is carried disproportionately by the seller. The seller cannot indicate a price that it is willing to receive nor can the seller withdraw from the market.

The high risk that sellers face about the uncertainty about market price for entitlements they are willing to sell is likely to act as a strong disincentive to participate in the market.

There is greater risk to Government because it is likely that the central market operator role would be conducted by the OLG. The rules however would be drafted in a way to manage that risk.

5.4.2 Fair

The Pooled Trading model does not treat buyers and sellers equally, imposing significant risk on the sellers.

A centrally operated market improves equity between larger and smaller venues because the level of resources required to participate is less. Similarly, the Pooled Trading model is more accessible than the Bilateral or Noticeboard models for venues located in regional areas.

5.4.3 Simple

This Pooled Trade model is simplistic in nature. Buyers would be required to submit bids indicating how many entitlements they are wishing to buy and the maximum price they are willing to pay, and sellers would submit a bid indicating how many entitlements they wish to sell. A central market operator would facilitate trade in each trading round and apply forfeiture prior to determining the average price for sellers.

5.4.4 Low-cost

The Pooled Trading model offers significantly lower search and transaction costs compared with the Bilateral Trading or Notice Board Trading models. In relation to search costs a single market process effectively eliminates the need for venues to search for a counter-party while channelling all transactions through the single market means that all participants can benefit from economies of scale.

5.4.5 Transparent

Under the Pooled Trading model, sales of gaming machine entitlements are effected through the managed tender process, even when the same licensee owns the sites. The market price is made public after the trading round has been completed. An impartial intermediary subject to rules conducts the process with significantly more checks and balances than the either the Bilateral Trading or the Notice Board Trading models.

5.4.6 Voluntary

Under the Pooled Trading model participation is purely voluntary.

Conclusion

The Pooled Trading model addresses the low-cost, fair and transparent market objectives better than either the Bilateral Trading or Notice Board Trading models can. However, it imposes significant risks on sellers that may discourage participation in the market and works against the overarching objective of “removing obstacles to trade in order to accelerate the reduction in gaming machine entitlements”.

The Pooled Trading model is not recommended.

5.5 Option 4: Periodic Trade

Under the Periodic Trading model, a central market operator would conduct tender processes periodically to create a full market. In the full market, the interaction of demand and supply would determine a market equilibrium price where all successful bidders would pay an amount consistent with their stated preferences while successful sellers would receive an amount consistent with their stated preferences.

The key aspect of this model option is the freedom each buyer and seller would have in placing his or her bid. Under the proposed model:

- buyers would indicate how many entitlements they wish to buy and the maximum price they are willing to pay; and
- sellers would indicate how many entitlements they wish to sell and the minimum sale price they are willing to receive.

Unlike the design of the Pooled Trading model, where sellers submit their bids without stipulating the minimum price they are willing to receive, the Periodic Trading Model allows for more flexibility. In this regard, buyers and sellers have the assurance that they will not pay more or receive less than they have indicated.

5.5.1 Low-risk

Risk is reduced through the establishment of clear market rules that are applied by an impartial intermediary. The Periodic Trading model also provides significant flexibility to buyers and sellers as they can choose to participate in the market and reflect their pricing preferences.

There is greater risk to Government because it is likely that the central market operator role would be conducted by the OLG. The rules however would be drafted in a way to manage that risk.

5.5.2 Fair

A centrally operated market improves equity between larger and smaller venues because the level of resources required to participate is less. Similarly, the Periodic Trading model is more accessible than the Bilateral or Notice Board Trading models for venues located in regional areas.

The Periodic Trading model is fair between buyers and sellers as both can clearly state their preferences about price.

5.5.3 Simple

The Periodic Trading model has more complex rules than the Pooled Trading model. The rules however are managed by the central market operator.

The interface with the buyers and sellers is relatively simple with an application form that contains a number of pre-qualification questions and buy/sell orders with:

- buyers indicating how many entitlements they wish to buy and the maximum price they are willing to pay; and
- sellers indicating how many entitlements they wish to sell and the minimum sale price they are willing to receive.

A buyer will never be obliged to buy an entitlement for a price more than the amount they indicated in their bid. Similarly, a seller will never be obliged to sell an entitlement for a price less than the amount they indicated in their bid.

5.5.4 Low-cost

The Periodic Trading model offers significantly lower search and transaction costs compared with the Bilateral Trading or Notice Board Trading models. In relation to search costs a single market process effectively eliminates the need for venues to search for a counter-party, while channelling all transactions through the single market means that all participants can benefit from economies of scale.

5.5.5 Transparent

Under the Periodic Trading model, sales of gaming machine entitlements are effected through the managed tender process, even when the same licensee owns the sites. The market price is made public after the trading round has been completed. An impartial intermediary, subject to rules, conducts the process with significantly more checks and balances than either the Bilateral Trading or the Notice Board Trading Market models.

5.5.6 Voluntary

Under the Periodic Trading model participation is purely voluntary.

Conclusion

The Periodic Trading model addresses the six market design objectives more comprehensively than the three other models and is the recommended market model for the Approved Trading System. The assessment is summarised in the table on the following page.

Summary of Market Models

		Bilateral Trade	Pooled	Periodic	Notice Board
		Criteria	low-risk	X	X
fair	X		X	√	X
simple	X		X	√	X
low-cost	X		√	√	√
transparent	X		√	√	X
voluntary	√		√	√	√

5.6 Submissions Relevant to the Periodic Trading Model

This section address a number of specific issues identified in submissions responding to the 2008 Consultation. The specific issues are:

- frequency of trades; and
- intra-group trades.

5.6.1 Frequency of Trades

The Collaborating Community Agencies stated in their submission that:

If the Government is convinced that trading rounds is the best mechanism for trade, then the legislation should state that at least two trading rounds will be conducted over any 12 month period, in this way providing for the option of additional trades occurring.

The Approved Trading System is established by Regulation. It is proposed that the Regulation will give the power to the Minister for Gambling as well as the Commissioner to initiate a trading round. It is the Government's intention to use this power to conduct at least two trading rounds per year. Indeed, initially, given the lack of trading rounds in recent times there may be a need for additional trading rounds in the first year or two.

5.6.2 Intra-Group Trades

The submission of ALH Group suggested that owners of multiple venues:

should be allowed to transfer electronic gaming machines freely between its properties at no penalty, subject to individual hotel caps.

It is not proposed to establish a transfer arrangement for hotels in addition to the Approved Trading System. This has the potential to introduce some of the undesirable elements of the Bilateral Trading model. The Periodic Trading model can accommodate hotel groups that seek to both buy and sell entitlements. Rules to address this specific circumstance will be included.

6 Qualification for Participating in the Approved Trading System

6.1 Introduction

This section outlines the qualification requirements for buyers and sellers who are seeking to participate in a trading round under the preferred Approved Trading System, the Periodic Trading model. OLGC will be the controlling authority for trading rounds conducted pursuant to the Approved Trading System.

This section addresses the following matters:

- applying to trade;
- paying a deposit; and
- the right to buy and sell entitlements.

6.2 Applying to Trade

Prior to a trading round OLGC will notify potential market participants that a trading round is to be conducted and the closing date for that round as follows:

- publishing a notice in the *Government Gazette* and *The Advertiser*;
- in writing to each licensee; and
- in writing to AHA|SA and Clubs SA.

A licensee who wishes to buy and/or sell entitlements will be required to complete an application form, prescribed by OLGC and lodge that form with OLGC, with the prescribed administration fee and deposit, before the prescribed closing date and time.

An application to participate in a trading round is valid only for the specified trading round and will not be carried over to the next round.

The following sections describe who are eligible buyers and sellers and why a deposit is proposed for buyers.

6.2.1 Who is eligible to buy in the trading round?

Licensees that have fewer gaming machine entitlements than the maximum number of gaming machines approved by OLGC are eligible to buy gaming machine entitlements up to that maximum through the trading round.

Buyers will be required to nominate on their application forms the number of gaming machine entitlements they wish to buy and the maximum price they are willing to pay for each gaming machine entitlement.

The licensee's application to trade must be complete and be accompanied by a deposit and administration fee prescribed by OLGC.

The Commissioner will have the discretion to prescribe the amount of the deposit. It is proposed that, initially, the deposit be set at \$10,000. The purpose of the prescribed deposit is to discourage offers to buy that are not genuine.

Any offer to buy that is successfully allocated an entitlement as result of the provisional market equilibrium (see section 7), but the buy transaction is not

completed by the due date for transfer of ownership, prescribed by the Commissioner, will result in the licensee forfeiting the deposit.

The forfeited deposit will be applied firstly to recover the cost associated with conducting the Approved Trading System and then to the Gamblers Rehabilitation Fund.

A licensee who has been excluded by the Commissioner for failing to complete buy transactions at an earlier trading round cannot apply to buy entitlements in relation to any licence that licensee may hold. The term of exclusion is at the discretion of the Commissioner.

6.2.2 Who is eligible to sell in the trading round?

Licensees who have at least one gaming machine entitlement are eligible to sell gaming machine entitlements in the trading round.

The licensee's application to trade must be complete and be accompanied with the documentation demonstrating that the licensee's ability to sell is unencumbered.

The application relating to a licensee with a lease relating to the licensed premises entered into prior to 1 February 2005 must be accompanied by the following documentation:

- copy of lease; and
- copy of landlord consent; or
- determination from the District Court.

Section 27B(5) of the *Gaming Machines Act 1992* provides detail regarding the determinations by the District Court regarding gaming machine entitlements and leases entered into prior to 1 February 2005.

The application form relating to a licensee with a lease relating to the licensed premises entered into on or after 1 February 2005 must be accompanied by:

- copy of the lease; and
- statutory declaration stating whether landlord (or mortgagee) consent is required and if so, a copy of consent.

Additionally, persons who have been granted an exemption by the Minister for Gambling under the proposed new section 76A of *Gaming Machines Act 1992* and who have taken possession of entitlements pursuant to that exemption can participate in the trading round. The application must be accompanied by:

- statutory declaration stating that the person has lawfully taken possession of the gaming machine entitlements and has the lawful right to dispose of those entitlements; and
- documentation referred to in the statutory declaration.

Sellers will be required to nominate on their application form how many gaming machine entitlements they wish to sell and the minimum price they are willing to receive for each gaming machine entitlement.

Further, the application will enable licensees to adjust the minimum price they are willing to receive for each gaming machine entitlement to account for the forfeiture rules (see section 7). This is achieved by taking the minimum price they are willing to receive for each entitlement and multiplying it by one and one third ($1\frac{1}{3}$). This adjustment will ensure that the licensee, if successful, will receive the required compensation as set out in the minimum price.

7 Conduct of the Trading Round

7.1 Introduction

The Approved Trading System will set a market equilibrium price and quantity traded through the interaction of bids placed by buyers and sellers.

The Approved Trading System will allow:

- buyers to indicate how many entitlements they wish to buy and the maximum price they are willing to pay; and
- sellers to indicate how many entitlements they wish to sell and the minimum sale price they are willing to receive.

The remainder of this section will discuss how the market equilibrium price is determined within a range of market scenarios in a trading round. Market rules will be developed along the way that will govern the way in which a trading round is conducted. The discussion will be under the following headings:

- **Creating Bid Stacks** – How are offers to buy and sell ordered in to bid stacks?
- **Forfeiture** – How will the one in four forfeiture rule be applied?
- **Determining a Provisional Market Outcome** - How will bids placed by buyers and sellers interact to set an equilibrium market price? Two relevant scenarios will be considered.
- **Market Scenarios** – Two specific market scenarios are considered.
- **Determining a Final Market Outcome** – What happens when a successful offer to buy is not completed by the licence holder?

7.2 Creating Bid Stacks

All bids received by OLGC for the trading round will be sorted in two bid stacks, from lowest to highest for sellers, and from highest to lowest for buyers. If there are bids of equal price then the position in the bid stack at that price is determined by random allocation.

Below is a table of “bids” that are provided as an example to work through the rules. They have been ordered in the way described above to create the buy and sell bid stacks. It is important to note that the values chosen for the bids are fictitious and do not represent an assessment of market value.

Offers to BUY	Bid Stack (Price \$)	Offers to SELL	Bid Stack (Price \$)
1	\$145, 000	1	\$75,000
2	\$140, 000	2	\$90,000
3	\$133, 000	3	\$95,000
4	\$126, 350	4	\$100,000
5	\$116, 150	5	\$125,000
6	\$89, 000	6	\$130,000
7	\$80, 000	7	\$135,000
8	\$75, 000	8	\$140,000
9	\$60, 000	9	\$143,000
10	\$50, 000	10	\$150,000

7.2.1 Market Rule

The sell bid stack is created by ordering the sell bids from lowest price to highest price. If there are bids of equal price then the position in the bid stack at that price is determined by random allocation.

The buy bid stack is created by ordering the buy bids from highest price to lowest price. If there are bids of equal price then the position in the bid stack at that price is determined by random allocation.

7.3 Forfeiture

After the bid stack has been created it must be adjusted by applying the one in four forfeiture requirement to all offers to sell. The forfeiture adjustment in the trading round is the most complex part of the Approved Trading System.

One in every four entitlements offered for sale by hotels is forfeited to the State. One in every four entitlements offered for sale by clubs will be forfeited to Club One.

Forfeiture adjustment is a two-step process. Both the price and quantity of offers to sell must be adjusted. The purpose of the adjustment is to ensure that the market outcome generates enough cash in from buyers to meet the cash out required to meet the successful bids from sellers, given that one in four entitlements have been forfeited.

7.3.1 Step 1 - Adjust Sell Offer Prices

The price of offers submitted will be adjusted to cover the bids that have been withdrawn from the trading round (one in four). The licensee will have calculated this adjusted amount on the application form.

The price of the remaining three entitlements in the trading round must cover the minimum amount required for the forfeited entitlement.

To achieve this, each offer price is multiplied by one and one third ($1\frac{1}{3}$).

There must be enough funds to cover the cost of all successful offers to sell.

7.3.2 Step 2 - Adjust Sell Offer Quantity

Each offer to sell must be multiplied by 0.75 because part of an entitlement cannot be traded in the market.

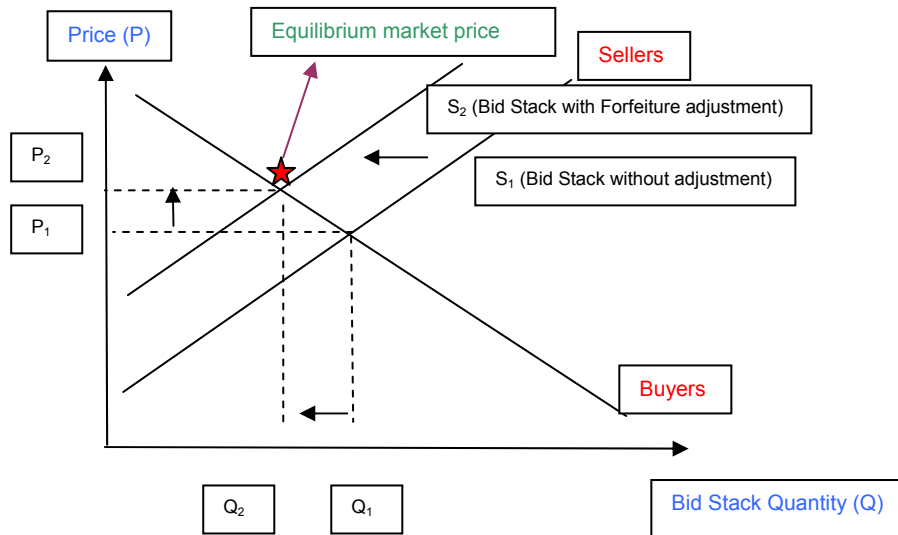
The number of entitlements offered for sale is rounded up.

Offers to SELL	Adj. Price (x 1.33r)	Adj. Quantity (x 0.75)	ROUND UP
1	\$99,750	0.75	1
2	\$119,700	1.5	2
3	\$126,350	2.25	3
4	\$133,000	3.0	3
5	\$166,250	3.75	4
6	\$172,900	4.5	5
7	\$179,550	5.25	6
8	\$186,200	5.0	6
9	\$190,190	6.75	7

Applying forfeiture has effectively reduced the number of gaming machine entitlements in the trading round and increased the price required to buy.

Below is a graphical representation of forfeiture. After adjusting the price and quantity for forfeiture, the supply curve, representing offers to sell, has shifted to the left. This has decreased the quantity of gaming machine entitlements available for trade from Q_1 to Q_2 and increased the price buyers will pay from P_1 to P_2 .

Forfeiture



It is possible that the total payments received by OLG from licensees buying gaming machine entitlements will be greater than the payments made by OLG to successful sellers in a trading round. This occurs due to the rounding associated with forfeiting one in every four entitlements offered for sale. Were this the result, the remaining funds will be applied to recover the costs associated with the Approved Trading System and any excess will be provided to the Gamblers Rehabilitation Fund.

7.3.3 Market Rule

The sell bid stack prices and quantities are to be adjusted to take account of forfeiture. The maximum price that a seller is willing to receive must be multiplied by one and one third ($1\frac{1}{3}$). The entitlement quantity associated with each price must be multiplied by 0.75 and rounded up.

7.4 Determining a Provisional Market Outcome

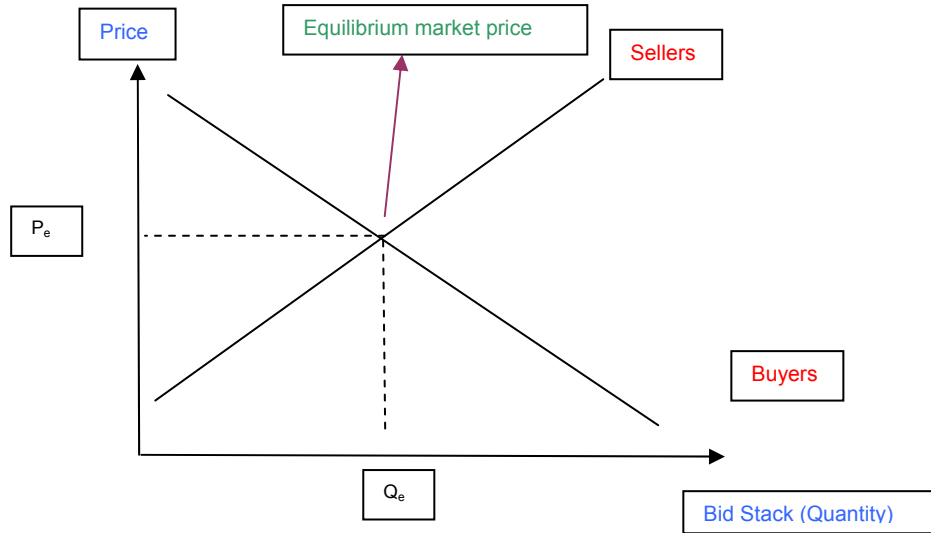
The figure on the next page graphically illustrates how bids submitted by buyers and sellers in a trading round act to create a market equilibrium price and quantity. This is based on the economic concept of supply and demand. A market equilibrium is the point at which supply and demand intersect. The price that applies to all transactions is P_e and at that price, the quantity traded will be Q_e .

It is possible to take the adjusted bid stacks to create supply and demand curves and to solve the market.

The quantity traded is determined by the position in the bid stack where the price in the buyers bid stack is minimised and is greater than or equal to the adjusted price in the

sellers bid stack. If those prices are equal then those prices are also the market equilibrium price that will apply to all successful trades.

Determining a Provisional Market Outcome



In the example below, bid stacks have been created and adjusted for forfeiture, indicating a market equilibrium price of \$133,000. The sell bids 3a and 3b and 6a and 6b are the outcomes of the rounding applied as part of the forfeiture rules discussed in the previous section. The double 3 and double 6 buy bids are the same bid applied twice to be considered against 3a and 3b and 6a and 6b.

In the case of sell bids 3a and 6a there are zero and one entitlements forfeited respectively due to rounding up. In the case of sell bids 3b and 6b one entitlement and two entitlements are forfeited respectively. The difference between the 'a' bid and the 'b' bid is the forfeited entitlement(s).

Offers to BUY	Bid Stack (\$)	BUY?	Market Equilibrium (\$)	Offers to SELL	Adj Bid Stack (\$)	SELL?
1	\$145,000	Y		1	\$99,750	Y
2	\$140,000	Y		2	\$119,700	Y
3	\$133,000	Y		3a	\$126,350	Y
3	\$133,000	Y	\$133,000	3b	\$133,000	Y
4	\$126,350	N		4	\$166,250	N
5	\$116,150	N		5	\$172,900	N
6	\$89,000	N		6a	\$179,550	N
6	\$89,000	N		6b	\$186,200	N
7	\$80,000	N		7	\$190,190	N
8	\$75,000	N		8	\$199,500	N
9	\$60,000	N		9	\$212,800	N
10	\$50,000	N				

The following section describes the characteristics of the bids that are successful or unsuccessful at the provisional market outcome. It uses this worked data set to illustrate the point.

7.4.1 Who was successful in the trading round?

Successful Offers to Buy

Offers submitted by buyers that are greater than or equal to the market equilibrium price, shall successfully be allocated a gaming machine entitlement. It is possible that not all buy bids are successful, for example where there is more than one buy bid at the market equilibrium price.

In the example above, offers to buy 1, 2, and 3 are successful because they have all indicated they are willing to pay greater than or equal to the market equilibrium price of \$133,000.

Successful Offers to Sell

Offers submitted by sellers, that indicated they are willing to receive less than or equal to the market equilibrium price of \$133,000 shall successfully sell their entitlements. In the above example, this includes sell offers 1, 2, and 3a and 3b. The fourth entitlement is forfeited.

7.4.2 Who was unsuccessful in the trading round?

Unsuccessful Offers to Buy

Those who submitted offers to buy at less than the market equilibrium price will be unsuccessful in the trading round. In the above example all bids below bid 3 are below the market equilibrium price of \$133,000 and therefore unsuccessful. In this case, licensees would have their deposit returned.

Unsuccessful Offers to Sell

The offers to sell below bid 3b are unsuccessful in the trading round because they are only willing to receive a price greater than the market equilibrium price. For example, offer number 8 is only willing to receive \$199,500 whereas the market equilibrium price is \$133,000.

7.4.3 Market Equilibrium Price

When offers submitted by buyers and sellers in a trading round do not result in the buy price equal to the adjusted sell price, a midpoint will be applied to the buy price and the adjusted sale price at the market quantity to be traded (determined previously).

On the next page is an example where the buy price and the adjusted sale price are not equal for the market clearing quantity. Offer 3a and 3b represents the market clearing quantity. Offer number 3 is willing to pay \$140,000, which is greater than the corresponding offer to sell of offer 3b \$133,000. Whilst these offers do not equal one another, a market equilibrium price will be determined by calculating the midpoint. Calculating the mid point between the two corresponding offers in the bid stack creates an equilibrium price of \$136,500.

Offers to BUY	Bid Stack (\$)		Offers to SELL	Adj Bid Stack (\$)
1	150,000		1	\$99,750
2	145,000		2	\$119,700
3	140,000		3a	\$126,350
3	140,000	Midpoint \$136,500	3b	\$133,000
4	92,000		4	\$166,250
5	89,000		5	\$172,900
6	80,000		6	\$179,550
7	75,000		6	\$186,200
8	60,000		7	\$190,190
9	50,000		8	\$199,500
10	40,000			

7.4.4 Market Rules

The quantity traded is determined by the position in the bid stack where the price in the buyers bid stack is minimised and is greater than or equal to the adjusted price in the sellers bid stack.

At that quantity, the market equilibrium price is either the buy price and the adjusted sell price when they are equal or if the buy price is greater than the adjusted sell price then it is determined by taking the midpoint between the buy price and the adjusted sell price.

The midpoint formula is $\frac{p_b + p_s}{2}$

Where p_b represents the price of the offer in the bid stack to buy and p_s represents the price of the offer in the bid stack to sell.

7.5 Market Scenarios

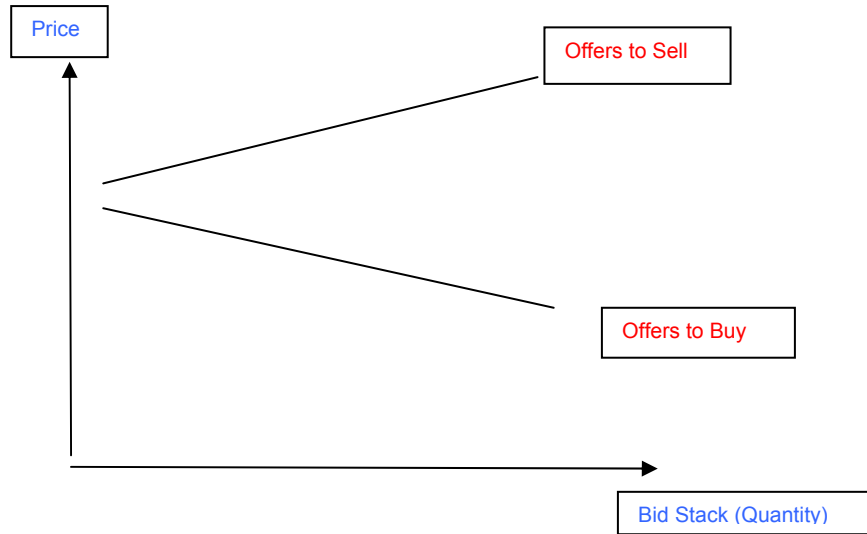
In addition to the scenario where the derived demand and supply curves intersect there are two scenarios where the derived demand and supply curves do not intersect. Those scenarios are discussed below and rules to handle them have been developed.

7.5.1 No Market Equilibrium Can Be Determined

An indefinite equilibrium may occur when buyers have submitted offers indicating they are not willing to pay greater than or equal to the minimum price willing to be received by sellers in a bid stack.

The figure on the next page depicts a graphical representation; showing offers to buy that never meet offers to sell.

Indefinite Equilibrium



For simplicity in this example, the forfeiture step has not been included.

A bid stack of the offers submitted may look like the below table:

Offers BUY	to	Bid Stack (\$)	Offers to SELL	Adjusted Bid Stack (\$)
1		125, 000	1	130, 000
2		120, 000	2	135, 000
3		100, 000	3	140, 000
4		90, 000	4	145, 000
5		75, 000	5	150, 000
6		65, 000	6	155, 000

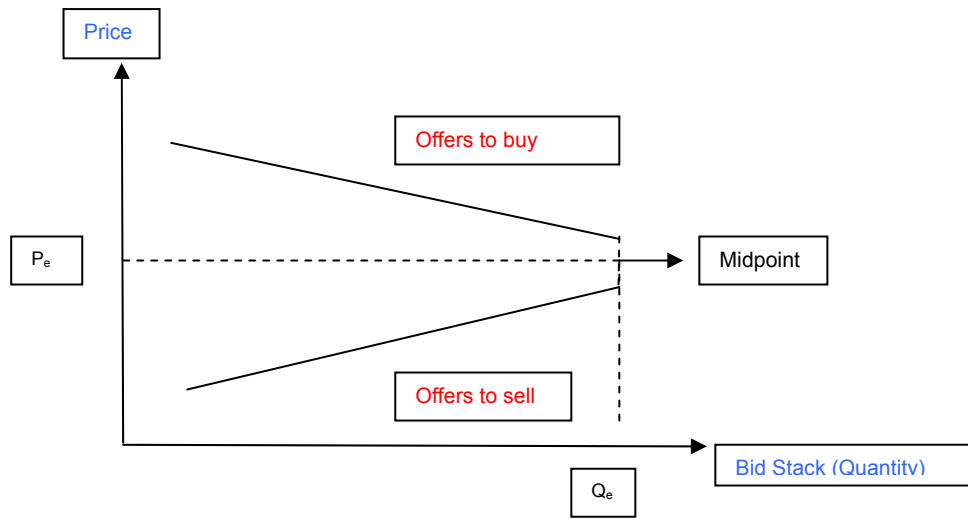
At no point in the trading round do bids offered by buyers and sellers satisfy the requirement for a trade to occur, i.e. no buyer is willing to pay the same or more than the adjusted price the seller is willing to receive. In this instance, the Commissioner will close the trading round and report nil market activity. The Commissioner will notify each buyer and seller that submitted an offer that his or her bid failed to result in any trade in the Approved Trading System.

At the Commissioner’s discretion, he may make a determination that a subsequent trading round should be held on a future date. All those who submitted offers to buy or sell entitlements will be notified and invited to participate in the subsequent trading round. An additional public notice will be published inviting those who did not participate in the initial trading round to submit an offer.

7.5.2 Excess Demand

The figure on the next page graphically shows excess demand when all of the prices offered by potential buyers are greater than all of the prices offered by potential sellers and there are more buyers than sellers.

Indefinite Equilibrium



In this scenario all of the offers to sell are satisfied, and the buy offers up to the total quantity available for sale are also satisfied. To facilitate trade, a market equilibrium price will be calculated in the bid stack at the midpoint between the highest offer to sell and the corresponding offer price to buy in the bid stack.

For simplicity in the example below, the forfeiture step has not been included.

Offers to BUY	Bid Stack (\$)	Midpoint	Adjusted offers to SELL	Adjusted Bid Stack (\$)
1	160,000		1	65,000
2	155,000		2	75,000
3	145,000		3a	90,000
4	140,000		3b	100,000
5	135,000		4	125,000
6	133,000	\$131,500	5	130,000
7	131,000			

Buyers who submitted offers 1, 2, 3, 4, 5, 6 and 7 have all indicated they are willing to pay equal to or greater than the highest sell offer.

In order for trade to be facilitated, a midpoint is taken between the highest offer in the bid stack from a seller, (\$130,000 in adjusted offer 5), and the highest corresponding offer in the bid stack for buyers (\$133,000 for offer 6). This results in a market equilibrium price of \$131,500.

7.5.3 Market Rules

Where the adjusted sell prices of offers to sell are greater than all of the prices of offers to buy, the Commissioner will report nil trade. A further trading round may be announced at that time.

Where all of the prices of offers to buy are greater than all of the adjusted sell prices of the offers to sell, then all of the sell offers are successful and all of the buy offers in the bid stack up to the total of entitlements available to sell are also successful. The market price is determined by taking the midpoint of

prices in the bid stack between the highest offer to sell and corresponding bid stack price to buy.

7.6 Determining a Final Market Outcome

Following determination of the provisional market outcome there will be an amount of time specified by the Commissioner to allow transactions to be completed. If any buyer is unable to complete the transaction then the deposit will be forfeited and that entitlement may be offered to other bidders in accordance with the rules described below.

7.6.1 Completion of Buy Transactions

Following the determination of the provisional market outcome, all applicants will be advised of their success or otherwise. Buyers will be notified of how many entitlements they were successful in buying and the total amount they must pay.

Buyers who successfully bought a gaming machine entitlement in the trading round will pay the market equilibrium price for each successful bid. The deposit that accompanied their application will be deducted from the total amount payable to OLGC.

Buyers in the Approved Trading System will have the period specified by OLGC to make payment for each entitlement allocated to them in the trade. If payment is not received the deposit associated with each successful bid will be forfeited. The Commissioner may elect to exclude buyers who fail to pay from a specified number of future trading rounds.

Buyers who have been unsuccessful will have the deposit that accompanied the application returned by the OLGC.

7.6.2 Calculation of the Final Market Outcome

If some buyers have not completed the transaction in the specified time then a revised final market outcome must be determined. Two outcomes may result:

- if there are no offers to buy that satisfy the offers for sale (i.e. the buy price is greater than or equal to the sell price), then the last gaming machine entitlement identified as successful at the provisional market outcome in the sale bid stack is not sold, the licensee will retain the entitlement; or
- if there are more offers to buy that satisfy the offers for sale (i.e. the buy price is greater than or equal to the sell price) then that bid is identified as successful and the licensee notified.

7.6.3 Completion of Sell Transactions

Once payment has been received from all buyers and the final market outcome has been determined, payments will be made to sellers.

Those sellers who have been successful in selling a gaming machine entitlement in the trading round will receive the market equilibrium price multiplied by 0.75 for each entitlement sold. This represents the unadjusted price in the bid stack and will be at least the minimum price the seller is willing to receive.

7.6.4 Market Rules

If a buy transaction has not been completed then the last gaming machine entitlement identified as successful at the provisional market outcome in the sale bid stack will be treated in one of the following ways:

- if there are no offers to buy that satisfy the offers for sale (i.e. the buy price is greater than or equal to the sell price), then the last gaming machine entitlement identified as successful at the provisional market outcome in the sale bid stack is not sold and is returned to the licensee; or
- if there are more offers to buy that satisfy the offers for sale (i.e. the buy price is greater than or equal to the sell price) then the next bid is identified as successful and the licensee notified.

8 Next Steps

The proposed next steps, subject to the *Gaming Machines (Miscellaneous) Amendment Bill 2010* being enacted by Parliament, are:

- receiving submissions on this consultation paper;
- preparing Regulations based on the proposal contained in this consultation paper and submissions received;
- further consultation with industry and the community sector on the detailed market rules through the Responsible Gambling Working Party. It is anticipated that a sub-committee will be established to work through the market rules in detail to ensure that interests of all parties are met;
- making the Regulations to implement the new Approved Trading System by early 2011; and
- commencing the first trading round under the new Approved Trading System in the first half of 2011.

Submissions that address the practical implementation of the recommended market model and its associated rules as described in this paper should be sent by email or post by no later than **Friday 3 September 2010** to:

e-mail: gamblingpolicy@sa.gov.au

post: Gambling Policy
Department of Treasury and Finance
GPO Box 1045
Adelaide SA 5001

It should be noted that submissions received will be placed on the Department of Treasury and Finance website and may be quoted in subsequent policy and/or consultation papers.

Additional copies of the consultation paper can be downloaded from:

<http://www.treasury.sa.gov.au/gamblingpolicy>