Unsolicited Proposals

REPORT FROM STEERING COMMITTEE

ASSESSMENT OF CROWN AND ECHO PROPOSALS

SUMMARY OF FINDINGS

JULY 2013

EXECUTIVE SUMMARY

A Government appointed Assessment Panel and an independently chaired Steering Committee have completed their Stage 2 assessment of the proposals submitted by Crown Ltd (Crown) and Echo Entertainment Group Ltd (Echo), consistent with the requirements of the NSW Unsolicited Proposal Guidelines.

This Report presents the summary of findings and recommendations from the parallel assessment processes.

After considering the Stage 2 proposals received on 21 June 2013, we concur with the Stage 1 conclusion that the two proposals are mutually exclusive. This is because both of Echo's proposed options seek exclusivity in a form that would not permit the Crown proposal to proceed.

Both the Crown and Echo proposals, supported by the analysis conducted by Deloitte Access Economics, confirm that:

- Sydney is falling short of its potential share of a rapidly growing international gaming and tourism market
- Sydney has underperformed compared with Melbourne, even though the single casino in Melbourne does not have exclusivity
- To be competitive requires an investment in integrated resort style facilities taking advantage of special locations, and
- The Pyrmont, Darling Harbour and Barangaroo precincts have the potential to become a virtual integrated resort, with a unique location on Sydney Harbour.

The Steering Committee believes that Sydney and NSW would derive greater benefit through a competitive casino market which delivers increased tourism and visitation as well as broader economic benefits. This will need to be managed by appropriate safeguards that minimise problem gambling.

This means, given the nature of the proposals and our assessment findings, that Crown should be offered the opportunity to move to Stage 3 with conditions. Establishing a competitive gaming market in NSW, with the attendant need for competitive neutrality would mean that there are a number of issues for the Government to consider if it accepts this recommendation. Clear negotiating parameters would be required for Stage 3. These are dealt with in this report below.

The Steering Committee believes that the recommendations, if adopted, would not exacerbate problem gambling associated with casino operations in NSW. Central to this is ensuring that the proposed commitments to responsible gaming programs are performed by operators. The Committee also recommends that additional third party exclusion measures to protect families be considered by Government.

David Murray AO

Steering Committee Chairman
July 2013

1 ASSESSMENT PROCESS

A Government Assessment Panel and an independently chaired Steering Committee have completed their Stage 2 assessments of Unsolicited Proposals from Crown Ltd and Echo Entertainment Ltd, consistent with the requirements of the NSW Unsolicited Proposals Guidelines.

Given the high level of public interest in casino style gambling and with development at Barangaroo, the Government appointed eminent independents to serve as Chairman of the Steering Committee and as a Probity Adviser after Crown's proposal was approved to progress to Stage 2 on 24 October 2012.

The Chair has been David Murray AO, former Chief Executive Officer of the Commonwealth Bank and Chair of the Australian Future Fund. The Probity Adviser has been the Hon. Ken Handley AO OstJ QC, a recently retired judge of the NSW Court of Appeal. Both agreed to extend their roles when Echo made its submission 3 April 2013 and Government approved progression to Stage 2 on 8 April 2013.

Mr Handley's probity report (attached) confirms that the Stage 2 assessment has been carried out by the Panel and Committee with transparency and fairness to both proponents, and with appropriate thoroughness and rigour in the interests of the State.

The assessment process has included 20 meetings with each proponent, and 2 meetings with the Chairs of the Steering Committee and Assessment Panel to review preliminary final proposals and identify key assessment issues.

A critical assessment of the business models from both proposals has been undertaken by the Panel, with the assistance of Deloitte Access Economics (Deloitte), to ensure that they are robust and that their forecasts for growth in markets, revenue and tax are credible.

It is important to understand that the assessment process is not the same as a tender evaluation. The Unsolicited Proposals Guidelines set out seven evaluation criteria, listed below. In this case, the two proposals are for different projects, with different requests of Government, and there is an established one–casino market to take into account.

Under the Unsolicited Proposals Guidelines, each proposal is assessed on its individual merits, in order to determine whether it would merit progression to Stage 3. The Steering Committee has overseen the parallel assessment of both proposals.

As the Stage 1 assessment of Echo's proposal (which was received after Crown's proposal) found that the two proposals were mutually exclusive, the Committee has also prepared advice for the Government on the options available to it under the Unsolicited Proposals framework. This Report contains the advice.

The Assessment Panel's Reports on each proposal, including economic assessment from Deloitte, have been prepared for public release alongside both proposals.

The Unsolicited Proposals process does not substitute or pre–empt any required legislative, regulatory or planning approvals, or the public consultation involved in each. These stages would follow any government agreement for a proposal to move to Stage 3.

2 CROWN PROPOSAL ASSESSMENT SUMMARY

Crown proposes to invest approximately $1.3billion to construct an iconic 6 star hotel and apartment building at Barangaroo South, including a VIP gaming facility. Crown seeks a VIP gaming licence to enable the project to proceed. The table below summarises the assessment of Crown's proposal against the criteria for assessments of Unsolicited Proposals.

UNSOLICITED PROPOSAL ASSESSMENT CRITERIA	ASSESSMENT OF CROWN'S PROPOSAL
Uniqueness	• Unique because Crown has secured an exclusive right to develop an iconic hotel in Barangaroo South.
Value to Government	• Crown offers an upfront licence fee of $250million or $100million, with tax rates of 9% or 10% for rebate play and 23% or 27.5% for non–rebate play. • Assessed increase in Gross State Product (GSP) of $442million per annum in 2025. • Assessed net present value (NPV) of extra tax and licence fee revenue of $441million to FY2035. • Investment of $1.3billion in construction and development • 1,250 additional direct jobs after construction. • Introduction of competition increases growth prospects for the gaming and tourism industries.
Whole of Government Impact	• Substantial contribution to international tourism growth, with a focus on high net worth Asian gaming market and local VIPs • Potential additional social harm from problem gaming is mitigated by exclusion of poker machines, minimum bet limits and membership entry requirements. Membership criteria need development. • Proposed tax rates that are inconsistent with competitive neutrality at current rates. • Requires change to legislation and development approval. • Principal opportunity cost is forgoing Echo's proposed $250million payment over 21 years to renew exclusivity.
Appropriateness of Return, considering risks	• Indicative project returns for the company are not excessive.

Crown's submission estimates an addition of $638million per annum to GSP in the first full year of operations (FY22). This has been scaled back to $388million in FY22 ($442million in FY25) following assessment because its forecast for growth rates for The Star under 'business as usual' is considered to be low. These adjustments also produce a proportional reduction in tax forecasts, producing an NPV of licence fee and tax of $441million to FY2035.

The estimate of Crown's contribution to GSP includes no provision for spending by its customers outside its premises, or for the benefits of investment that Echo might reasonably make in response to the introduction of a competitor.

Sydney has underperformed compared with Melbourne, where Crown operates a single casino that does not have exclusivity. Crown has continuously re–invested in its facilities and has achieved total revenue over 60% greater than The Star. This indicates a track record of successful and consistent operations by Crown, which adds confidence that its proposed investment should benefit NSW.

Crown has proposed two licence fee and taxation options. One offers a higher up–front licensing fee of $250million, while the other offers higher ongoing tax rates of 10% for rebate play and 27.5% for non–rebate play with a licence fee of $100million. Recommendations regarding tax options are included below.

UNSOLICITED PROPOSAL ASSESSMENT CRITERIA	ASSESSMENT OF CROWN'S PROPOSAL
Capability	• Delivery of the proposal is clearly within the assessed capabilities of Crown.
Affordability	• Neither Government nor taxpayers are making any contribution to the project cost. • The Government has incurred the cost of the assessment process.
Risk allocation	• Investment and project risk is appropriately retained by Crown. • Risk of revenue falling below forecast levels is considered to be low based on anticipated growth in the international gaming market. • Introduction of competition reduces the risk that Sydney will continue to underperform in this industry compared to competing cities.
Recommendation	• Merits progression to Stage 3 if the conditions as recommended in Section 6 are agreed by Crown.

3 ECHO PROPOSAL ASSESSMENT SUMMAR

Echo proposes to invest $1.1 billion to create an integrated resort on its existing site at Pyrmont, including public domain investment for a pedestrian bridge to Barangaroo, embellishment of waterfront parks and walkways, and an upgrade of the light rail station. Echo seeks a 15 year extension of The Star's exclusivity arrangement to provide certainty for its investment.

The table below summarises the assessment of Echo's proposal against the criteria for assessments of unsolicited proposals.

UNSOLICITED PROPOSAL ASSESSMENT CRITERIA	ASSESSMENT OF ECHO'S PROPOSAL
Uniqueness	• Unique because Echo already holds the State's only casino licence and no other party could apply for an exclusivity agreement.
Value to Government	• Echo proposes $250million for renewed full exclusivity or $0 for renewed partial exclusivity. Both options also seek a $250million per annum increase in the threshold at which rate escalation begins (for non–rebate, ie local play). • Assessed increase in GSP of $350million per annum in 2025. • Estimated net present value of extra tax and licence fee revenue of $337million to FY2035. • Investment of $1.1billion in construction and development, including $130million for public domain • 1,460 additional direct jobs after construction.
Whole of Government Impact	• Substantial contribution to international tourism growth, with a focus on middle class Asian tourists, high net worth Asian international VIPs, and interstate tourists. • Potential to increase problem gambling as Echo proposes to raise [redacted] million pa extra from poker machines by removal of $10 maximum bet limits on 1,250 machines. • Requires development approval. • Principal opportunity cost is forgoing benefits of Crown's proposed investment, potentially partly substituted by construction of a lesser hotel at Barangaroo.

UNSOLICITED PROPOSAL ASSESSMENT CRITERIA	ASSESSMENT OF ECHO'S PROPOSAL
Appropriateness of Return, considering risks	• Indicative project returns for the company are not excessive.
Capability	• Delivery of proposal is within the assessed capabilities of Echo.
Affordability	• Neither Government nor taxpayers are making any contribution to the project cost. • The Government has incurred the cost of the assessment process.
Risk allocation	• Investment and project risk is appropriately retained by Echo. • Risk of loss of existing forecast potential tax revenues is considered to be low. • Proposed investment by the proponent reduces the risk that Sydney will continue to underperform in this industry compared to competing cities. • Government bears reputational risk if public domain investments are not executed.
Recommendation	• If Government decides to retain a one–casino model, proposal merits progression to Stage 3 if the removal of bet limits on poker machines is limited to VIP or other approved private areas.

Echo has proposed that its project would add $350million per annum to NSW GSP in 2025. Our analysis supports this. Its NPV of extra tax and licence fee revenue is assessed at $337million to FY2035.

The Committee believes that Echo's proposal represents a more sophisticated integrated resort model than its more recent investment to upgrade The Star, and materially expands its existing hotel room numbers. The Committee think it is likely that Echo would be motivated to undertake at least some of its published strategic investment plans in response to the introduction of competition, whether its proposal was successful or not.

4 COMPARATIVE EVALUATION

Both proposals meet the three qualification criteria and perform satisfactorily against the four performance criteria as required under the NSW Government Unsolicited Proposal Guidelines. However, as both of Echo's options require exclusivity in a form that is incompatible with Crown's proposal to include domestic VIP gaming, the proposals are mutually exclusive and therefore only one can proceed.

The economic assessment observes that Crown's contribution to GSP is 26% larger than Echo's in FY2025 and that Crown's NPV of extra tax and licence fee revenue are 31% larger than Echo's, respectively. The Committee is satisfied that the modelling and analysis have been conducted in a robust and consistent way to enable reliable comparison of economic and taxation outcomes from proposed investments.

However, the Committee is cognisant that the indicated results ultimately depend on whether the proponents are successful in achieving projected growth. This will be determined by the quality of their strategies, execution, resilience and wider market conditions. For this reason, assessed impacts on GSP and taxation revenue are not considered a sufficient basis alone for selection between the two proposals.

Comparison of the proposals has focused on achieving the best outcome for NSW. Both proposals and the assessment, supported by the analysis conducted by Deloitte, confirm that:

- Sydney is falling short of its potential share of a rapidly growing gaming and tourism market
- Sydney has underperformed compared with Melbourne, even though the single casino in Melbourne does not have exclusivity
- To be competitive requires an investment in integrated resort style facilities taking advantage of special locations, and
- The Pyrmont, Darling Harbour and Barangaroo precincts have the potential to become a virtual integrated resort, with a unique location on Sydney Harbour.

The Committee therefore believes that the decisive factor in the choice between Crown's and Echo's proposal is the opportunity to introduce competition.

5 ISSUES FOR THE STATE

COMPETITION

The presence of a second casino will create sustained incentives for improvements in performance, making Sydney more attractive to tourists overall. The cities that are most notably successful in the global gaming markets (Macau, Singapore, and Las Vegas) all have more than one casino, with differentiated offerings targeting different market sectors.

NSW currently operates a one casino model. Accordingly the transition to competition requires adjustments to taxation and regulatory settings to establish a level playing field which is also conducive to investment and growth.

TAXATION

Crown has proposed two taxation options, and neither is wholly consistent with existing rates.

In the category of international and interstate rebate based play. Crown's 10% flat tax option is the same as at The Star, and would thus deliver competitive neutrality.

In the category of non–rebate based play, Crown's 27.5% option is equal to the base tax rate paid at The Star. However, The Star is subject to marginal rates that will rise to 50%. The Committee recommends that non–rebate based play should be taxed at a flat rate to maintain competitive neutrality. The majority of the Committee, including the Chair, support a flat rate of 29% which will provide an environment conducive to investment and growth, without material risk to taxation revenue. The alternative view was the flat tax rate should be 31% which would provide the State with a better share of any potential upside in the casino gambling market. These tax rates are inclusive of GST of 9.09% and the Responsible Gambling Levy of 2%. The Star will be transitioned to the same flat rate when its exclusivity period ends.

GAMING REGULATION AND PROBLEM GAMBLING

The Committee has sighted evidence from the Productivity Commission that the social impacts of casino gaming can be managed through responsible gaming measures and minimising reliance on mass market poker machines.The Committee has noted that both proposals include a commitment to deliver substantial responsible gaming programs. It recommends that the Government also consider establishing a third party exclusion program to protect families at casinos in NSW, as has been adopted in ACT, South Australia and New Zealand.

The issue of VIP definitions has been contested in the proposals. It is a relevant matter for determination of taxes and licence fees, and to prevent a gradual expansion of gaming beyond the VIP market sector that Crown has proposed to serve. The Committee has included recommendations to better define VIP Gaming.

GOVERNMENT LEGAL, FINANCIAL AND REPUTATIONAL RISK

There are important risks for the Government to consider. Issues connected with competition, social harm, and taxation are considered above. Other risks are:

Planning approvals. While not a matter for the Committee to determine, obtaining planning approval is a risk that must be retained in full by Crown. Crown's current proposed building is materially taller than the site's existing approved envelope. It would be up to Crown to ensure that any reduction required by the planning decision–maker in the numbers of floors, hotel rooms or apartments could be accommodated.

Completion risk (contractual and project). Approval and execution of the proposal is complex. Most of the risks will be borne by Crown. Stage 3 documentation should be structured with particular care to ensure that the State's interests are protected. This would include early payment for a gaming licence, once granted, as proposed by Crown.

Legislative risk. The Casino Control Act 1992 will need to be amended to remove the one casino policy.

In a competitive setting, there will be a higher likelihood of project commitment and delivery. The business model adopted elsewhere by Crown, and its success in Melbourne, gives confidence that its project will be completed.

6 STEERING COMMITTEE RECOMMENDATIONS TO GOVERNMENT

1. ESTABLISH COMPETITION AND DO NOT EXTEND EXCLUSIVITY

Echo's proposal to extend exclusivity until 2034 is not consistent with establishing competition, and should therefore not be progressed. Nevertheless, in pursuing regulatory reforms to establish competitive neutrality, the Government should consider ways in which Echo would be incentivised to invest in The Star without compromising the State's position on tax revenue and problem gambling.

2. OFFER CROWN THE OPPORTUNITY TO MOVE TO STAGE 3 WITH CONDITIONS

Crown's proposal for VIP gaming, with an upfront licence fee of \$100million (paid within 20 business days of issuing the licence) and a tax rate for rebate based play of 10% (including GST), should be progressed to Stage 3 with four additional conditions. The conditions for moving to Stage 3 are:

- Adopting the majority position of the Steering Committee that non–rebate play would be taxed at 29% (including GST and the responsible gaming levy) not 27.5% as proposed by Crown, and
- The total of licence fee and gaming tax payments to NSW over the first 15 years of full operation must exceed \$1billion (nominal), a guarantee Crown proposed for its alternate option, and
- Licence fee and tax would be reviewed after 20 years of operation, having regard to market conditions, financial viability and competitiveness, and the licensee earning a fair return on capital. Timing for the review of both casinos will be aligned, and
- Local VIP membership criteria must include a 24 hour cooling off period for applicants who cannot demonstrate a track record of VIP gaming at other casinos, rules to ensure that guests are bona fide, and regular reviews of members gaming to ensure that they should remain as members.

For clarity, Crown should also be asked to confirm the Committee's understanding of the Crown proposal in relation to the following matters:

- The costs of regulation of Crown Sydney will be met by Crown. The Independent Liquor & Gaming Authority (ILGA) will determine day to day regulatory requirements and investigate a system of third party exclusion procedures, to protect families, which will apply to all casinos in NSW.
- The approach to regulation of the two casinos in NSW will be consistent (including front money for rebate play) and that the Government will initiate a review of regulatory efficiency to ensure that contemporary, effective and productive procedures are employed and continually refined.

As advised, Crown is requested to pay the Government a non–refundable \$5 million deposit to enter into Stage 3, which would be credited against its licence fee payment if a licence is granted.

3. IF CROWN DOES NOT ACCEPT THE OFFER, GO TO TENDER

If the above conditions are not accepted by Crown, then the Government should consider conducting a tender process for a licence to establish a second gaming and tourism resort in Sydney.

The Hon Ken Handley AO, OstJ, QC

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Joint Steering Committee for the
Crown Sydney Resort Project & Echo Entertainment Group Ltd
Department of Premier & Cabinet
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Dear Committee members

Probity Report on the Assessment of Stage 2 Unsolicited Proposals from Crown Limited and Echo Entertainment Group Limited

On the 24 of October 2012 Cabinet decided that the unsolicited proposal received from Crown Ltd on 6 September should proceed to Stage 2 assessment under the Government's Guidelines for such proposals. On 5 February 2013 I was appointed as the Probity Adviser to the Steering Committee chaired by Mr David Murray AO, and the Assessment Panel chaired by Mr Simon Smith of the Department of Premier and Cabinet replacing the previous Probity Adviser.

Since my appointment I have attended all meetings of both bodies except those between 16 May and 18 June when I was traveling under arrangements made before my appointment which were disclosed to Mr Simon Smith at the time. While I was away I remained in email contact with members of the Panel and Committee, receiving 36 emails and sending 19.

I initially focused on 2 issues. Did Crown have the legal rights it claimed over the Barangaroo site which "uniquely" entitled it to make its unsolicited proposal under the Guidelines? Secondly did Deloitte Touche Tomatsu Australia(Deloittes), the adviser to the Committee and Panel on accountancy and taxation aspects of Crown's proposal , possibly have a conflict of interest ? Such a possibility may have arisen because a subsidiary of Crown owns 33.3% of the issued shares in Melco Crown Entertainment Ltd of Macao (Melco) and Deloittes China are the external auditors of Melco.

I was aware of comments in the Press prior to my appointment suggesting that the relationship between the Deloitte firms created a conflict of interest. I also considered that the contractual restraint on Deloittes against accepting professional engagements from Crown and related companies was too short.

I asked representatives of Crown at meetings of the Panel for a copy of the agreement between Lend Lease and Crown which was said to give Crown the exclusive right to develop the Barangaroo site, but for some time could only obtain a redacted copy which was useless for my purpose. Crown was in a difficult position because it was contractually bound to treat the agreement as confidential, and Lend Lease would not allow disclosure of the whole document. Mr Murray and I insisted on disclosure and Lend Lease eventually agreed to our inspecting it at their office in the presence of their in-house counsel, under obligations of confidentiality. I was therefore able to satisfy myself that Crown had the exclusive development right it claimed.

The agreement between the Government and Deloittes prevented the firm accepting engagements from the Crown group as long as they were working for the Government on this project. I considered that this gave the Government inadequate protection from the appearance of conflict that would arise from an engagement of the firm by Crown shortly after it completed work on this project. I hasten to add that I had no reason to suspect that Crown would offer such an engagement or that Deloittes would accept it. Moreover to my observation their partners and staff working on this project acted throughout with professional skill and integrity in the interests of the State. Nevertheless I was concerned that such an engagement, however unlikely, would raise doubts in the mind of the public about the independence and rigour of their work and create the appearance of a conflict of interest.

Accordingly I advised the Steering Committee that Deloittes should be asked to accept a restraint against such engagements for a further 2 years. When Mr Murray intervened they accepted a restraint for two.

My other concern related to the position of Deloittes China as auditor of Melco. I was informed that the Australian firm had no interest in that firm or in that audit, and the firms were completely independent. I sought documentary verification and eventually was given a copy of the Articles of Association of Deloitte Touche Tomatsu Ltd, a company limited by guarantee incorporated in the United Kingdom. The various Deloittes firms worldwide are members of this company and its articles of association govern the relationship between them. I checked the articles and read documents generated by the firm's conflict management department in 2012 in which they concluded that the position of the China firm did not create any conflict which could prevent the Australian firm examining Crown's then relationship with Echo through its 10% shareholding, or Crown's unsolicited proposal. I was satisfied that Deloittes had no right to share in the profits of the China firm and no responsibility for its liabilities and it had no conflict of interest in carrying out its retainer for the review of the Crown and Echo proposals.

The agenda papers for all meetings of the Panel and Committee without representatives of Crown or Echo being present included provision for disclosures of any conflicting interest. Some disclosures were made out of superabundance of caution, such as living in Pyrmont, but these did not reveal any reason for doubting the integrity and impartiality of those concerned. Nothing came to my attention at any stage which suggested that any of the persons on the Government side had an actual or possible conflict of interest.

Having attended all meetings of both committees since my appointment, apart from those while I was out of Sydney, and been kept informed of relevant developments during my absence, I am satisfied that the assessment process for both proposals has been conducted on the Government side thoroughly and with rigour with a view to securing the best possible financial result for the State. The rigour of the process was enhanced when Cabinet decided that Echo's unsolicited proposal of 3 April.

2013 should be taken through the Stage 2 process by the same Steering Committee and Assessment Panel. Echo's only proposal at that time was inconsistent with Crown's and introduced an element of competition which could not be present when a single unsolicited proposal was being considered.

Some of aspects of the final proposals are a substantial improvement on those originally foreshadowed by the proponents, and have been included despite earlier resistance to suggestions from the Panel or the Committee that they were appropriate. I am satisfied that the assessment for Stage 2 has been carried out by the Panel and Committee with transparency and fairness to both proponents, and with appropriate thoroughness and rigour in the interests of the State.

Yours sincerely

The Honourable K R Handley AO OStJ QC.