

**NSW AUDITOR-GENERAL'S REPORT  
PERFORMANCE REVIEW**

**NSW Lotteries Sale Transaction**



The Legislative Assembly  
Parliament House  
SYDNEY NSW 2000

The Legislative Council  
Parliament House  
SYDNEY NSW 2000

In accordance with Division 2A of the *Public Finance and Audit Act 1983*, I present a report titled **NSW Lotteries Sale Transaction**.

A handwritten signature in black ink that reads 'Peter Achterstraat'.

Peter Achterstraat  
Auditor-General

Sydney  
November 2010

**State Library of New South Wales cataloguing-in publication data**

New South Wales. Audit Office

NSW Lotteries Sale Transaction [The Audit Office of New South Wales].

978 1921252 471

1. New South Wales Lotteries. 2. Tattersall's. 3. Lotteries - Privatization - New South Wales - Evaluation.  
4. Consolidation and merger of corporations - New South Wales - Evaluation.-  
I. Title: NSW Lotteries sale transaction. II. Title: NSW Auditor-General's report : performance review : NSW Lotteries  
sale transaction.: III. Title: Performance review : NSW Lotteries sale transaction.

338.83617953809944  
352.26609944

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## Executive summary

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## Preface

I intended to conduct a review of the NSW Lotteries Sale Transaction as part of my financial audit of the Crown Entity and the Total State Sector Accounts for the year ended 30 June 2010 under section 27B(3) of the *Public Finance and Audit Act 1983*. However, NSW Treasury recently obtained two legal advices from the Crown Solicitor about my powers to undertake such a review as part of my financial audit. The Crown Solicitor advised NSW Treasury that such an audit or review would not be authorised under section 27B(3), but had to be conducted under my performance audit powers in Division 2A of the Act. I therefore issued the initial draft of the report to NSW Treasury under this Division of the Act.

After further consideration, I have decided to issue the report as a “performance review”, as defined by Australian auditing standards, rather than the more extensive “performance audit”. The standard (*ASAE 3500 Performance Engagements*) provides a basis for both. The report is still issued under Division 2A of the Act.

## Background

The sale of NSW Lotteries to Tattersall’s Holdings Pty Limited, a wholly owned subsidiary of the Tatts Group Limited (Tatts Group) occurred on 31 March 2010. The sale was the result of a competitive bid process coordinated by NSW Treasury. The NSW Government received approximately \$1.011 billion from the transaction. This included a cash and asset extraction plus a \$850 million payment from the successful bidder for an exclusive 40 year public lotteries license, the purchase of the shares in NSW Lotteries Corporation, the retention and use of unclaimed prizes, and other concessions.

Following the announcement of the successful bidder on 2 March 2010, a number of concerns were raised by various parties alleging significant deficiencies in the sale process. In particular, it was suggested that the Tatts Group should not have been allowed to include the retention and use of unclaimed prizes in its bid.

The objective of this review was to assess if there was wastage of public resources or a lack of probity or financial prudence in the sale process. Our criteria for this assessment were whether:

- acceptance of a bid based on an alternative transaction structure was in accordance with the rules for the bid process
- all bidders were provided with the same information in relation to the treatment of unclaimed prizes
- the value to the Government of unclaimed prizes was properly assessed
- the successful bid’s treatment of unclaimed prizes was legal.

## Conclusion

Nothing has come to my attention in this review of the NSW Lotteries Sale Transaction to indicate there has been a waste of public resources or lack of financial prudence.

I am concerned, however, about the absence of documentation supporting key recommendations of the Review Committee. The absence of documentation conflicts with one of the principles outlined in the Lotteries Probity Plan which relates to transparency and accountability.

Whilst various documents stated the Government's intention for unclaimed prizes to be transferred to the Government, bidders were also informed that proponents could not rely on any statement by or on behalf of the State during the process and that the Minister retained discretion in the exercise of his functions under the *Public Lotteries Act 1996*.

## Supporting findings

**Was acceptance of a bid based on an alternative transaction structure in accordance with the rules?**

I found no evidence to indicate that the successful bid was inconsistent with the rules. The rules specified that a proponent must submit a binding offer based on the Government's preferred transaction structure. A second binding offer could also be submitted based on an alternative transaction structure.

The key official document describing the bid process (Process Letter) used the terms "transaction structure", "preferred transaction structure", "alternative transaction structure", "alternative structure", and "alternative structures for the Transfer". These terms were not well defined and had the potential to cause some confusion.

**Were all bidders provided with the same information in relation to the treatment of unclaimed prizes?**

I found no evidence to indicate that all bidders were not provided with the same information in relation to unclaimed prizes. Information on the treatment of unclaimed prizes was provided to prospective bidders through formal letters, briefings from Communities NSW and an on-line data room. This 'room' included draft transaction documentation, and a database of questions raised by prospective bidders and the answers provided to them.

While there is no doubt that official documents and statements from officials involved in the sale clearly said that unclaimed prizes would be transferred to the Government, bidders were also informed that "proponents could not rely on any statement by or on behalf of the State during the process" and that the Minister retained discretion in the exercise of his functions under the *Public Lotteries Act 1996*. The Process Letter also did not clearly state whether the Government could utilise ideas in bids, such as the proposal by Tatts Group to retain unclaimed prizes, to propose a new basis for subsequent bids. It should have made this clear.

**Was the value to the Government of unclaimed prizes properly assessed?**

Due to the limited documentation available I am unable to directly examine the methodology and results of the assessment. However, based on statements made, documents recreated, and other material provided, I found no evidence to indicate that the value of unclaimed prizes was not properly assessed, based on the assumptions used.

Detailed documentation of the assessment of the value of unclaimed prizes was not produced. What limited documentation was produced did not adequately demonstrate how the Review Committee determined its recommendation. The lack of documentation on this issue, involving a high value asset, is a serious deficiency in recordkeeping relating to the sale process.

**Was the successful bid's treatment of unclaimed prizes legal?**

I found no evidence to indicate that the inclusion of unclaimed prizes in the successful bid was precluded by the *Public Lotteries Act 1996*. NSW Treasury advised that during the review of the bids its legal adviser discussed this issue with a representative of the Crown Solicitor's Office, and that both concluded there was no legal impediment that precluded the bidder from retaining unclaimed prizes in their alternative bid.

This advice was oral with some supporting eMail correspondence. It would have been prudent for the legal advice to be obtained in writing. A formal written analysis was only performed by the legal adviser after the transaction was concluded and after concerns had been raised about the legality of the treatment of unclaimed prizes. This analysis was cleared by Senior Counsel and concluded that the direction issued by the Minister and approved by the Treasurer was a valid exercise of the Minister's discretion.

### **Recommendations**

In the conduct of any future sales, NSW Treasury should ensure that:

1. where the Government chooses to conduct a process on the basis that "proponents could not rely on any statement by or on behalf of the State during the process" this point is continuously reinforced to proponents
2. the Process Letter clearly states that the Government's representatives involved in the transaction process cannot fetter the discretion or decision of a Minister
3. key terms are clearly defined and consistently applied to avoid ambiguity and confusion
4. significant decisions, advice and analysis of issues during the transaction process are formally documented and retained to improve accountability and transparency
5. significant guidance or advice to potential bidders is provided in writing
6. arrangements for dealing with intellectual property that may be contained in bids are clearly defined and communicated at the start of the process.



## Response from NSW Treasury

*Thank you for providing me with the Performance Audit - NSW Lotteries Sale Transaction. This letter sets out NSW Treasury's comments on the report, pursuant to section 38C of the Public Finance and Audit Act 1983.*

### **Summary**

*NSW Treasury is proud of the outstanding result achieved through the sale of NSW Lotteries. The sale price achieved was considerably in excess of both retention value to Government and the market expectations at the time.*

*We welcome the key findings of the Performance Audit, which are:*

- *"I found no evidence to indicate that the successful bid was inconsistent with the rules detailed in the Process Letter"*
- *"I found no evidence to indicate that all bidders were not provided with the same information in relation to unclaimed prizes"*
- *"...I found no evidence to indicate that the value of unclaimed prizes was not properly assessed, based on the assumptions used"*
- *"I found no evidence to indicate that the inclusion of unclaimed prizes in the successful bid was precluded by the Public Lotteries Act 1996."*

*We note the audit conclusion that:*

- *"Nothing has come to my attention in this audit of the NSW Lotteries Sale Transaction to indicate that there has been any waste of public resources or lack of financial prudence."*

*We also note the recommendations contained in the report. In our view, some of the recommendations are largely superfluous because the recommended course of action is consistent with what actually took place in the Lotteries transaction process. However, we will remain mindful of these matters in future transactions. We address each of the audit recommendations later in this letter.*

*The comments concerning an absence of documentation and record-keeping are acknowledged but not accepted by NSW Treasury and its Advisers. The members of the Review Committee and Steering Committee considered they had all relevant and appropriate information and briefing materials so as to allow them to make a recommendation on all aspects of the transaction and to properly discharge their duties.*

*To clarify what appeared to be some confusion at the Audit Office about the nature of the Audit and the legislative support for same, NSW Treasury obtained legal advice on the matter which was supplied to the Audit Office.*

### **Scope of the Audit is very narrow**

*We consider the scope of the Report to be too narrow in focus for a Performance Audit of a major asset sale. The Report appears to be focused almost exclusively on a number of unsubstantiated and unsourced assertions which were aired primarily through the media at the time of the transaction. Consequently, the Report does not cover major and important aspects of the transaction process.*

*The content of the Report does not reflect the comprehensive transaction process and it is essentially silent on the excellent value for money outcome for taxpayers. Specifically, topics which we believe the Report could have addressed but does not are:*

- *whether the transaction result delivered good value for money having regard to the objectives of the transaction*
- *Government's residual risk position following the Transaction*
- *execution risk(s)*
- *adherence to the Selection Plan and decision making to specified key decision criteria*
- *achievement of Government's stated transaction objectives*
- *confirmation that the best bid was selected according to the review criteria (as assessed by the Audit Office under their independent review)*
- *the existence and application of an appropriate probity framework within which the transaction activities were undertaken.*

### **Audit Process**

*To assist the Audit Office in its review NSW Treasury made available the Selection Plan outlining details as to how the review of offers was to be performed, all offer documentation received (including financial models provided by each proponent), all transaction documentation and the Evaluation Report prepared for the transaction Steering Committee by the Review Committee.*

*In addition to making available all the relevant information, senior members of NSW Treasury and its financial, legal and probity advisers who were directly involved in the Transaction including the evaluation of offers met with the Audit Office on several occasions to discuss the Transaction process and findings of the Review Committee.*

*To our knowledge the Audit Office did not interview as part of its audit of the Transaction representatives from Communities NSW, the regulator of the NSW Lotteries business, or senior Communities NSW personnel that participated as members of the Review Committee and Steering Committee.*

*In some areas the supporting discussion in the Report seems inconsistent with the key findings and conclusions.*

### **Tatts Group's offer provided best value**

*The NSW Lotteries transaction delivered an excellent financial return for taxpayers, unlocking over a billion dollars which has been used to strengthen the State's finances. The transaction proceeds were nearly double the retention value and significantly exceeded market expectations. Reports by analysts at the time valued NSW Lotteries between \$500m and \$630m, yet the transaction ultimately achieved a price of \$850m, plus the undisclosed additional cash extraction, which is referred to in the Report.*

*We note the Report's observation that Tatts Group's base and alternative offers were both assessed as the best against all the evaluation criteria. However, the discussion about Tatts Group having the lowest forecast duties is very simplistic. The Review Committee's assessment included a detailed review of each proponent's business plan, including the duty forecasts. In that regard we make the following points:*

- *It needs to be understood that no proponents were guaranteeing payment of a future duty stream - these future revenue streams would have been entirely at risk to Government. Only the up-front payments were certain.*
- *The merits and achievability of each proponent's business plan were considered relative to each other and in the context of the upfront payments, key financial assumptions, potential regulatory implications, certainty of funding and the contractual terms of each offer.*

#### ***Treasury and its Advisers dispute claims of an absence of documentation***

*The Report cites an absence of documentation supporting decisions. Any suggestion of an absence of documentation is not accepted by either NSW Treasury or its Advisers.*

*The valuation and legal issues relating to unclaimed prizes were considered and fully assessed by the Review Committee (with the benefit of supporting experts advice) as part of recommending the Tatts Group's alternative offer to the Steering Committee.*

*Material in relation to the valuation of unclaimed prizes was prepared for the Review Committee, which combined with the detailed verbal briefings provided by the Financial Adviser, was sufficient so as to allow the Review Committee to make a recommendation in this respect.*

*Further, the comments about an absence of documentation seem somewhat inconsistent with the key finding that "I found no evidence to indicate that the value of unclaimed prizes was not properly assessed, based on the assumptions used."*

*As part of its offer, Tatts Group provided a fully-integrated financial model that had been independently audited by a reputable advisory firm. This enabled evaluation of the value of unclaimed prizes to be analysed and commented on.*

*In relation to documentation as to the legality of the treatment of unclaimed prizes, we note the Report's observation that there were contemporaneous emails demonstrating that the approach adopted was satisfactory in a legal sense. Furthermore, a partner from the State's legal adviser, provided real-time advice directly to the Review Committee and Steering Committee during the evaluation process.*

#### ***Unclaimed prizes were part of a package deal that represented good value for money***

*The Report notes that the successful offer from Tatts Group was \$147m - \$188m higher than its base offer and included among other things the conditional retention of unclaimed prizes.*

*In assessing the value for money from Tatts Group's alternative offer, it is important to note that the conditions attached to the use of unclaimed prizes were such that they will be used to generate higher sales. This in turn generates higher duty payments to the Government. Whilst, under the transaction, the Government has foregone the unclaimed prizes that could otherwise have been paid into the Consolidated Fund, this is offset to a large degree by the higher expected duties that stem from allowing unclaimed prizes to be reinvested in the business. NSW Lotteries' previous experience and management team supported the view that the use of unclaimed prizes to promote lotteries results in higher duty payments to the Government.*

*The Report correctly notes that the net cost to Government of allowing Tatts Group to retain unclaimed prizes, after allowing for the increased duties, was assessed as \$20m - \$40m. This range was determined based on sensitivity tests that were performed around a number of assumptions relevant to the valuation of unclaimed prizes and increased duties.*

*The additional value offered by Tatts Group, noted in the Report to be in the range of \$147m - \$188m, compares very favourably with the assessed net cost associated with unclaimed prizes of \$20m - \$40m. The attractive value for money proposition was demonstrably obvious to the Review Committee, even after allowing for the fact that unclaimed prizes was not the only condition attached to Tatts Group's alternative offer.*

*The analysis provided by the financial adviser for the audit supports the Review Committee's assessment of unclaimed prizes. In this regard we note the observation in the Report that "the conclusions drawn by the Review Committee were not unreasonable."*

*The observation that "statements from officials involved in the sale clearly said that unclaimed prizes would be transferred to the Government" is correctly qualified by the observation that the context for communication with bidders was one where it was also made clear that the Minister's discretions in relation to such matters could not be fettered. Further, the Treasurer's letter appended to the Report makes very clear what proponents were (and were not) told about unclaimed prizes by NSW Treasury and its Advisers.*

#### **Response to Recommendations**

1. Where the Government chooses to conduct a process on the basis that "proponents could not rely on any statement by or on behalf of the State during the process" this point is continuously reinforced to proponents.

*In our view this message was provided continuously to proponents throughout the transaction process, with statements to this effect appearing in the Request for Qualifications, Process and Confidentiality Deed and Management Presentation. The State's legal adviser has also advised that this point was made continuously to all proponents at meetings on the transaction structure and transaction documents.*

2. The Process Letter clearly states that the Government's representatives involved in the transaction process cannot fetter the discretion or decision of a Minister.

*The State's legal adviser has advised that this point was emphasised to all proponents at meetings on the transaction structure and transaction documents. It is also documented in the Communities NSW regulatory presentation. However, we accept that it could also have been referred to in the Process Letter. The recommendation will be taken into account for future transactions.*

3. Key terms are clearly defined and consistently applied to avoid ambiguity and confusion.

*In our view, the content of the final offers received clearly indicates that each proponent understood the terms used in the Process Letter. In this regard, we do not agree with the observation in the Report that terms used in the Process Letter were "not well defined" or "had the potential to cause some confusion". Nevertheless, this recommendation will be taken into consideration for future transactions.*

4. Significant decisions, advice and analysis of issues during the transaction process are formally documented and retained to improve accountability and transparency.

*Treasury and its Advisers do not accept that there is an absence of documentation or any lack of accountability and transparency in relation to the NSW Lotteries transaction.*

*In our view, significant decisions, advice and analysis of issues in relation to the NSW Lotteries transaction were adequately dealt with and documented in the Review Committee's report and other material and correspondence.*

*We consider that the probity requirements of accountability and transparency have been fully met on the basis that the process followed in making a recommendation to the Treasurer, and the roles and responsibilities of the various parties involved, is documented in the Review Committee's report.*

*Treasury will continue to ensure that the highest standards of accountability, transparency and probity are applied in future transaction processes.*

5. Significant guidance or advice to potential bidders is provided in writing

*This recommendation is supported. Care will need to be taken to ensure that any written guidance or advice could not be interpreted as fettering Ministerial decision-making.*

6. Arrangements for dealing with intellectual property that may be contained in bids are clearly defined and communicated at the start of the process

*The Process Letter undertook that the content of binding offer documents would be kept confidential, unless Government reporting, audit or legal requirements necessitated disclosure. This confidentiality undertaking included any intellectual property contained in proponents' offers. The position regarding intellectual property is clear. We consider the recommendation to be largely superfluous, but it will be taken into consideration for future transactions.*

*Thank you for giving us the opportunity to comment on the Report.*

*(signed)*

*Michael Schur  
Secretary*

*Dated: 19 November 2010*



## Key findings

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## 1. The Sale Transaction

The sale of NSW Lotteries to Tattersall's Holdings Pty Limited, a wholly owned subsidiary of the Tatts Group Limited (Tatts Group) occurred on 31 March 2010. All bids were made on the basis that a cash extraction of \$128 million from the NSW Lotteries Corporation would be made to the Government before the sale.

The NSW Government received approximately \$1.011 billion from the NSW Lotteries Sale Transaction. This comprised:

- the extraction of cash and other assets to the net value of \$161 million
- Tatts Group payments of \$850 million.

Tatts Group received in return an exclusive 40 year public lotteries licence, the shares in the NSW Lotteries Corporation, an offset against incremental GST changes, losses if the State fails to enforce the exclusivity of the licence, the right to issue new products without a licence fee and to allow the retention and use of unclaimed prizes over the 40-year licence period.

The sale was the result of a competitive bid process coordinated by NSW Treasury.

The estimated retention value of NSW Lotteries was \$510 million. The methodology used to calculate this value appears reasonable. Three of the bidders included an up-front payment in excess of this amount in their bids under the government's preferred transaction structure.

The up-front payment offered by Tatts Group in its bid under the Government's preferred transaction structure was the highest offered under this structure and was marginally higher than the second highest up-front payment offer under the preferred structure.

Following the announcement of the successful bidder on 2 March 2010, a number of concerns were raised by various parties alleging significant deficiencies in the sale process. These included suggestions that:

- the Tatts Group bid was non-conforming, as unclaimed prizes were meant to be turned over to the NSW Government instead of being retained by the Tatts Group
- other bidders were not given the opportunity to include unpaid prizes to increase their bids, and they were told they could not bid for unclaimed prizes
- the value of unclaimed prizes could be as high as \$300 million, and yet the Tatts Group paid no more than \$150 million for the right to retain the prizes
- the Tatts Group's treatment of unclaimed prizes was illegal.

NSW Treasury and the Probity Adviser noted that despite the suggestions in the media, there were no official complaints made directly to the Probity Adviser, even though all bidders were afforded the opportunity to do so in the rules for the transaction provided to all bidders. However, there were a number of issues raised with NSW Treasury by a representative of an unsuccessful bidder which were not considered by NSW Treasury or the Probity Adviser to be official complaints. The unsuccessful bidder later confirmed in writing that there was no official complaint.



Bidders were required to submit a binding offer based on the Government's preferred transaction structure. At the same time a second binding offer could also be submitted based on an alternative transaction structure. All conforming bidders submitted alternative bids, which included a variety of proposals. These proposals remained undisclosed to other bidders as they were treated as the intellectual property of the individual bidder in accordance with the rules for the process.

#### **Outline of NSW Lotteries Sale Transaction Process**

The process included the following:

- creation of a Steering Committee to oversight the process
- establishment of a committee to review bids (the Review Committee). The Review Committee comprised representatives of NSW Treasury, Communities NSW, Goldman Sachs JBWere, Gilbert and Tobin and a lottery industry expert. Assistance was also provided by the Crown Solicitor's Office, who provided legal advice at the request of the Committee's Chair. A probity adviser was appointed to oversight the sale transaction and develop a probity plan
- development of a detailed selection plan and processes to be followed by the Review Committee in reviewing and assessing bids
- a qualification process to determine the suitability of the bidders under the *Public Lotteries Act 1996*, including extensive probity and other checks by the regulator of public lotteries in New South Wales, Communities NSW
- distribution of instructions to all qualified potential bidders in a letter dated 1 November 2009 regarding the NSW Lotteries Transaction - Request for Binding Offers (Process Letter). The instructions included rules for the conduct of the process, and outlined the evaluation criteria to be applied by the Review Committee
- establishment of an on-line data room which provided proponents access to relevant information, and enabled the submission of questions through a Question and Answer process
- due diligence reports and briefings.

The pre-determined criteria against which bids were evaluated comprised financial and non-financial considerations, including:

- the level of financial and contractual certainty
- the extent to which the up-front payment appropriately valued the transaction, having regard to the Government's objectives for the transaction
- the extent to which the business plan appropriately met the objects and suitability requirements of the *Public Lotteries Act 1996*
- the extent to which the financing arrangements were sufficient.

NSW Treasury has advised it incurred \$9.9 million on consultants for the transaction. The transaction costs represent 1.2 per cent of the \$850 million up-front payment.

Following evaluation by the Review Committee against the criteria, the bid by Tatts Group was recommended by the Review Committee to the Steering Committee and approved by the Treasurer. This bid was based on an alternative transaction structure and was assessed as the best bid against all the evaluation criteria, including providing the highest upfront payment to the Government. This was the only bid that included a proposal for any retention of future unclaimed prizes.

The Tatts Group's bid based on the preferred transaction structure was also assessed as the best preferred transaction structure bid against all the evaluation criteria.

While the successful bid had the highest upfront payment to Government, it had the lowest figure in relation to "Forecast Duties" to be payable to Government over the life of the licence. One of the bidders forecast it would be very substantially increasing sales revenue to an extent that would deliver significantly more duties to the Government than would be delivered by the successful bidder. This was in the order of hundreds of millions of dollars. The Review Committee's analysis of this bid, which included the benefit of advice from a lottery industry expert and from the Office of Liquor Gaming and Racing, indicated that the long-term projected revenues to the State were of low achievability, due largely to the forecasts in relation to the dollar spend of disposable income. Tatts Group's forecasts were assessed as substantially more likely to be achieved than this bidder's forecasts and acceptable in terms of harm minimisation.

I also note the difficulty of commenting on the appropriateness of the assumptions as to future events over the 40 years due to their subjective nature and the uncertainty as to future events.

I asked NSW Treasury why the State did not go back to the unsuccessful bidders requesting them to re-submit their bids on the basis of the proposed treatment of unclaimed prizes contained in the Tatts Group alternate bid. NSW Treasury advised that:

'To go back to bidders in this way would have been inconsistent with the process we advised to bidders prior to them lodging their bids. Further, it would have been a breach by the Government of confidentiality, it would have created probity issues and would have been unfair to Tatts in sharing the intellectual property of their bid with other bidders. Other bids contained intellectual property which was not accessible to any other bidder.'

The Probity Adviser submitted to NSW Treasury an unqualified probity report on 26 March 2010.

## 2. Was acceptance of a bid based on an alternative transaction structure in accordance with the rules for the bid process?

### Key finding

I found no evidence to indicate that the successful bid was inconsistent with the rules detailed in the Process Letter.

The rules specified that a proponent must submit a binding offer based on the Government's preferred transaction structure. A second binding offer could also be submitted based on an alternative transaction structure. A binding offer had to be irrevocable, unconditional and legally binding, capable of immediate acceptance on the terms and conditions outlined in the bid documents.

NSW Treasury advised that the process was designed in this manner to ensure bids made aligned with the Government's preferred transaction structure, while allowing for individual proponents to use their intellectual property and ideas to add value to the transaction in an alternative bid.

The rules included an outline of the criteria against which all bids, including bids using an alternative transaction structure, would be assessed. We sighted the evaluation report of the Review Committee detailing their assessment of all bids made against these criteria. As noted above, the successful bid was rated as the best bid against these criteria.

The Process Letter used the terms "transaction structure", "preferred transaction structure", "alternative transaction structure", "alternative structure", and "alternative structures for the Transfer". These terms were not well defined and had the potential to cause some confusion. However, NSW Treasury has advised that all conforming bidders submitted bids based on the Government's preferred transaction structure and on an alternative transaction structure. In NSW Treasury's and its financial adviser's view this demonstrated that the bidders understood the rules for the sale process. The financial adviser has indicated that it did not receive any enquiries about the Process Letter.

The successful bid was based and accepted on an alternative transaction structure as allowed for in the rules. The Review Committee's legal adviser indicated to us that he saw no impediment to accepting this bid.

The rules for the bid process were structured to reserve maximum flexibility to the Government. This flexibility was explicitly stated in the Process Letter as follows:

'The Government reserves the right in its discretion to amend the Process as it sees fit and may decide not to accept any binding offer and not to enter into any transaction at all.'

It was also made clear in the Process Letter, and the Confidentiality and Process Deed signed by each bidder, that the Government may accept or reject bids at their discretion, regardless of their price or perceived value to the State.

Notwithstanding the flexibility the Government reserved to itself in the Process Letter, the Probity Plan set out the principles of fairness and proper process that applied to the transaction. NSW Treasury advised:

‘that rules to allow flexibility are common for such transactions and the reason for this flexibility was to allow for a situation where a bidder may propose a structure which is not compatible with policy, for example, a proliferation of outlets accessible by minors.’

**Recommendation** It is recommended that in the conduct of any future sales, NSW Treasury should ensure that key terms are clearly defined and consistently applied to avoid ambiguity and confusion.

The use of the word ‘structure’ in the Process Letter and particularly what was meant by an ‘alternative transaction structure’ had the potential to confuse bidders.

### **3. Were all bidders provided with the same information in relation to the treatment of unclaimed prizes?**

**Key finding**

I found no evidence to indicate that all bidders were not provided with the same information in relation to unclaimed prizes.

Information on the treatment of unclaimed prizes was provided to prospective bidders through the data room, formal letters from the Review Committee and briefings from Communities NSW. The data room included draft transaction documentation, and a database of questions raised by prospective bidders and answers provided.

The Treasurer has advised that:

‘No proponent was told categorically by project advisers that unclaimed prizes would be transferred to the Government.

No proponent was told by project advisers that unclaimed prizes could not be included in their offer.’

NSW Treasury has advised that it was made clear to all bidders that all information provided was based on the Government’s preferred transaction structure.

Under the Government’s preferred transaction structure the liability and associated cash for any unpaid prizes was to remain with NSW Lotteries for 12 months from the date of the draw. After that date the liability and associated cash would be transferred to the State. The State would then be responsible for future claims against the unclaimed prizes pool.

Communities NSW provided prospective bidders with a presentation titled ‘Guidance on the NSW Lotteries Regulatory Framework’ and a draft document ‘Public Lottery Operating Standards - a guide to the operating standards under the *Public Lotteries Act 1996*’.

The Presentation stated:

‘Unclaimed Prizes transferred into Consolidated Fund. An unclaimed prize is defined in the Act as ‘a prize that remains unclaimed by the prize winner for a period of one year after the date on which the relevant lottery was conducted’. The act further requires those unclaimed prizes to be paid into the Consolidated Fund (ie to Treasury).’

While clearly stating that unclaimed prizes will be transferred to the Government, bidders were also informed that the Minister retained discretion in the exercise of his functions under the *Public Lotteries Act 1996*. I also note that any decision to transfer funds depends on an approval by the Treasurer.

The draft Operating Standards included the following which is essentially the same wording as Section 27A(2) of the *Public Lotteries Act 1996*:

‘unclaimed prizes kept by the Licensee must be paid into the Consolidated Fund as directed by the Minister and approved by the Treasurer following consultation with the Licensee.’

At the start of the Presentation the following point was made:

‘While the Presentation provides an indication of the proposed approach to the regulation of lotteries, nothing in the Presentation should be construed as limiting or constraining the Minister or his delegates in the exercise of their functions under the Act.’

The database of questions and answers contained the following question in respect of unclaimed prizes:

‘Does the State intend to transfer or underwrite prizes won but not claimed prior to privatisation and able to be claimed up to 1 December 2016 at which point the new arrangement for claims is fully implemented?’

The answer provided in the database available to all bidders was:

‘As part of the transaction, the State intends to transfer a portion of the PRF [Prize Reserve Fund] liability to the State prior to completion and an equal amount of cash. The liability for "unclaimed prizes" (i.e. unpaid prizes greater than 12 months) will remain with the State.

Following completion, the State intends to transfer on an ongoing basis the liability for all unclaimed prizes and the associated cash from NSW Lotteries to the State. This will be done on a monthly rolling basis. Any future claims for such unclaimed prizes will be an obligation of the State.

The liability and associated cash for any unpaid prizes (ie less than 12 months old) will remain with NSW Lotteries until such time those unpaid prizes become unclaimed prizes (ie prizes that are not claimed 12 months after the draw).’

I requested the Treasurer to confirm details of advice provided to bidders in respect of unclaimed prizes. The undated response from the Treasurer received on 24 June 2010 is included as Appendix 2. In his letter the Treasurer advised:

‘All communication with proponents took place in the context of a confidentiality and process deed that made it clear that proponents could not rely on any statement by or on behalf of the State during the process.’

The information in this response is consistent with my review of various documentation and interviews with officials involved in the transaction. The Confidentiality and Process Deed referred to by the Treasurer also covered the database of questions and answers, including the answer on the transfer of unclaimed prizes referred to above.

As noted above, bidders were invited to submit a bid based on an alternative transaction structure. Bidders seem to have interpreted the information provided in different ways and structured their bids accordingly. However, I found no documentary evidence to indicate that any bidder was provided with information relating to unclaimed prizes that was not available to all bidders.

When a preferred transaction structure and an alternative transaction structure are allowed for in a bid process it should be made explicitly clear when providing information to bidders whether the information relates to the preferred transaction structure or the alternative transaction structure. For example, the Process Letter should state that briefings and Questions and Answers will be given in the context of the preferred transaction structure, and these answers do not preclude bidders from applying different solutions in their alternative transaction structure.

Ideally, all key points should be made in the Process Letter. Where they are not, such as “you have one chance to make a bid, we will not be going back to give further opportunities”, such points still need to be made formally in writing.

The Process Letter indicated that despite any intellectual property or ownership rights which may apply, the Government would be entitled to retain bidders’ offer documents but gave undertakings that those documents would be treated confidentially and would not be disclosed to other bidders.

NSW Treasury advised:

‘that it was not considered appropriate, from a probity perspective, to change the defined process for the sale transaction once the bids had been received. Therefore the option of retaining unclaimed prizes contained in the Tatts Group alternative bid was not made available to other bidders. In the same way, ideas proposed by other bidders were not made available to Tatts Group.’

The Process Letter should have clearly stated whether the Government could utilise ideas in bids to propose a new basis for subsequent bids.

- Recommendations** In the conduct of any future sales, NSW Treasury should ensure that:
- where the Government chooses to conduct a process on the basis that “proponents could not rely on any statement by or on behalf of the State during the process” this point is continuously reinforced to proponents
  - the Process Letter clearly states that the Government’s representatives involved in the transaction process cannot fetter the discretion or decision of a Minister
  - significant guidance or advice to potential bidders is provided in writing
  - arrangements for dealing with intellectual property that may be contained in bids are clearly defined and communicated at the start of the process.
- 4. Was the value to the Government of unclaimed prizes properly assessed?**

**Key finding**

Due to the limited documentation available I was not able to directly examine the methodology and results of the Review Committee’s assessment. However, based on statements made and other material provided by the financial adviser, I found no evidence to indicate that the value of unclaimed prizes was not properly assessed, based on the assumptions used.

Tatts Group successful bid (which included among other things the conditional retention of unclaimed prizes) was in the order of \$147 to \$188 million <sup>1</sup>(including an additional cash extraction) more than its bid under the Government’s preferred transaction structure.

**Documentation of analysis was not adequate**

The Review Committee did not produce detailed documentation of its assessment of the value of unclaimed prizes. What limited documentation was produced did not adequately demonstrate how the Review Committee determined its recommendation. The lack of documentation on this issue, involving a high value asset, is a serious deficiency in the recordkeeping relating to the sale process.

NSW Treasury and their financial adviser stated that the proposal to retain and use unclaimed prizes was subject to financial analysis and that the results of the analysis were considered by the Review Committee in its assessment of the recommended bid. Further that this analysis demonstrated ‘value for money’ under certain scenarios including a variety of discount rates and different forecasts about the quantum of the future unclaimed prizes stream.

However, a formal record of this analysis was not produced. As such I am unable to directly comment on the analysis considered by the Review Committee.

<sup>1</sup> The precise figure is subject to a confidentiality agreement between NSW Treasury and Tatts Group.

This lack of documentation is not satisfactory for consideration of such a key issue in the assessment of the bid. As this modelling supported a critical decision in the transaction it should have been properly documented, signed off by the committee and retained with relevant papers. This would include the appropriateness of the assumptions used in the modelling.

NSW Treasury advised:

‘Members of the Review Committee had considerable background in relation to the legal, financial and accounting analysis of unclaimed prizes. Members of both the Review Committee and the Steering Committee, which had different membership, were fully satisfied with the verbal briefings provided by the financial adviser on this issue, which was not complicated in their view. The Review Committee did not seek formal documentation on the analysis of unclaimed prizes.’

The Review Committee’s financial adviser has stated its analysis was conducted using estimates of the Government’s cost of funding and NSW Lotteries cost of capital. It included sensitivity analysis using various scenarios and assumptions to project cash-flows over the 40 year term. The key assumptions included the extent of unclaimed prizes and future revenue streams from the sale of lottery products. I am not in a position to comment on the appropriateness of the assumptions due to their subjective nature and the uncertainty as to future events.

**The financial adviser recreated the analysis for us**

The financial adviser has provided me with details of how the analysis was carried out and the basis for the conclusion drawn as to the value of unclaimed prizes by the Review Committee. The financial adviser recreated the analysis for my review. Based on this information, the conclusions drawn by the Review Committee were not unreasonable.

In relation to the stream of unclaimed prizes, there were two options available to the Government:

- (1) Government to retain unclaimed prizes over the 40-year licence period. This was estimated to have a Net Present Value (NPV) of \$73 million to \$281 million, based on certain assumptions made, including the rate at which unclaimed prizes decline over time and the cost of capital.
- (2) The Government allow the winning bidder to retain the unclaimed prizes for the 40-year licence period to be used for certain prescribed purposes (re-invest in the business for marketing, promotions, etc), which would produce increased returns to Government via a higher duty stream. This was assessed as having a NPV to Government of \$34 million to \$263 million.

The financial adviser assessed the net cost to Government of taking Option 2 as being a NPV of \$20 million to \$40 million.

The Tatts Group’s alternative bid contained a number of variations to the Government’s preferred transaction structure as set out in the Process Letter. The Review Committee determined that, taken as a whole, the alternative bid provided the best financial return for the Government and recommended that this bid be accepted.



NSW Treasury advised:

‘The Tatts alternative offer involved an additional \$X million<sup>2</sup> in proceeds to the State (inclusive of additional cash extracted from the NSW Lotteries Corporation’s balance sheet immediately prior to completion). In return for this, the State accepted four requirements of Tatts alternative offer.

Assessment of each of these additional elements involved qualitative assessment of risks to the State and, where possible, quantitative assessment of the cost to the State of these conditions.

Overall, the Review Committee and the Steering Committee were satisfied that the additional \$X million<sup>3</sup> offered by Tatts in return for these conditions represented good value for money.’

**Recommendation** In the conduct of any future sales, NSW Treasury should ensure significant decisions, advice and analysis of issues during the transaction process are formally documented and retained to improve accountability and transparency.

## 5. Was the successful bid’s treatment of unclaimed prizes legal?

**Key finding**

I found no evidence to indicate that the inclusion of unclaimed prizes in the successful bid was precluded by the *Public Lotteries Act 1996*.

This issue was considered by the Review Committee’s legal adviser during the review of the bids and was discussed with a representative of the Crown Solicitor’s Office. Both concluded there was no legal impediment that precluded the bidder from retaining unclaimed prizes in their alternative bid.

The above advice was oral. However I have sighted a series of emails between legal advisers demonstrating that this issue was considered.

Documented formal legal advice should have been obtained. Indeed as there was no reference in the Process Letter to the treatment of unclaimed prizes I would have expected that written legal advice would have been obtained clarifying this matter prior to accepting the bid.

A formal written analysis was only performed by the Review Committee’s legal adviser in April 2010 after the transaction was concluded and after concerns had been raised about the legality of the treatment of unclaimed prizes. I have sighted the formal written advice prepared after the sale was completed which confirmed the oral advice. This advice had been reviewed and settled by Senior Counsel in conference and concludes that:

<sup>2</sup> The precise figure is subject to a confidentiality agreement between NSW Treasury and Tatts Group.

<sup>3</sup> The precise figure is subject to a confidentiality agreement between NSW Treasury and Tatts Group.

- the direction issued by the Minister and approved by the Treasurer under section 27A of the *Public Lotteries Act 1996*, in relation to unclaimed prizes, was a valid exercise of the Minister’s discretion
- there was no reason to change any law to give effect to the treatment of unclaimed prizes provided for by the direction.

The advice is comprehensive and also states that:

‘... [section 27A(2)] does not in terms impose an obligation upon the licensee to pay unclaimed prizes to the consolidated fund. If that had been Parliament’s intention, section 27A(2) could simply have provided:

“Unclaimed prizes in a prize fund kept by the licensee must be paid to the Consolidated Fund”.’

**Exhibit 1: *Public Lotteries Act 1996* - Section 27A,  
Unclaimed prizes**

- (1) The regulations may make provision for or with respect to the time within which claims for unclaimed prizes must be made.
- (2) Unclaimed prizes in a prize fund kept by a licensee are to be paid into the Consolidated Fund as directed by the Minister with the approval of the Treasurer and after consultation with the licensee.
- (3) After an unclaimed prize is paid into the Consolidated Fund any liability to pay the prize to the prize winner becomes a liability of the Crown and payment of the prize to the prize winner is authorised to be made from the Consolidated Fund.

Source: *Public Lotteries Act 1996*

While contrary legal opinions have been aired in the media, I found no evidence that it was inappropriate for the Review Committee to rely on the legal advice it received. However, it would have been prudent for the Review Committee to have obtained this advice in writing.

**Recommendation**

Again, it is recommended that in the conduct of any future sales, NSW Treasury should ensure significant decisions, advice and analysis of issues during the transaction process are formally documented and retained to improve accountability and transparency.

## Appendices

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<b>Appendix 1</b>	<b>About the review</b>
<b>Objective</b>	The objective of this review was to assess if there was wastage of public resources or a lack of probity or financial prudence in the sale process.
<b>Criteria</b>	<p>We used the following criteria (the ‘what should be’) to judge performance, ie whether:</p> <ul style="list-style-type: none"><li>• acceptance of a bid based on an alternative transaction structure was in accordance with the rules for the bid process</li><li>• all bidders were provided with the same information in relation to the treatment of unclaimed prizes</li><li>• the value to the Government of unclaimed prizes was properly assessed</li><li>• the successful bid’s treatment of unclaimed prizes was legal.</li></ul>
<b>Scope</b>	<p>The review focused on suggestions that:</p> <ul style="list-style-type: none"><li>• the Tatts Group bid was non-conforming, as unclaimed prizes were meant to be turned over to the NSW Government instead of being retained by the Tatts Group</li><li>• other bidders were not given the opportunity to include unpaid prizes to increase their bids, and they were told they could not bid for unclaimed prizes</li><li>• the value of unclaimed prizes could be as high as \$300 million, and yet the Tatts Group paid no more than \$150 million for the right to retain the prizes</li><li>• the Tatts Group’s treatment of unclaimed prizes was illegal.</li></ul> <p>The review excluded consideration of:</p> <ul style="list-style-type: none"><li>• whether NSW Lotteries should have been sold</li><li>• whether all the Government’s objectives for the sale were achieved.</li></ul>
<b>Approach</b>	<p>The team:</p> <ul style="list-style-type: none"><li>• reviewed reported concerns raised in respect of the transaction to identify our lines of inquiry, including material sent to my Office by a participant in an unsuccessful bid</li><li>• interviewed relevant NSW Treasury officials and reviewed relevant documents made available to me</li><li>• interviewed the Probity Adviser and reviewed the scope of the adviser’s engagement and final report</li><li>• interviewed relevant members of the Review Committee who were engaged by NSW Treasury to assist in the NSW Lotteries sale transaction</li><li>• discussed with the Review Committee’s financial adviser the analysis used to calculate the net present value of inclusion of unclaimed prizes in the winning bid.</li></ul>

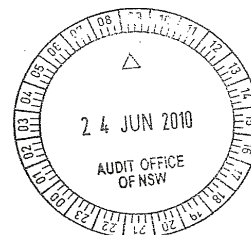
<b>Selection</b>	This topic was selected to address issues of public interest. A number of concerns were raised by various parties alleging significant deficiencies in the process for the NSW Lotteries Sale Transaction, and that this had led to waste of public money.
<b>Methodology</b>	<p>We used a methodology designed to satisfy the Australian Standard on Assurance Engagements <i>ASAE 3500 on Performance Engagements</i> and comply with the <i>Public Finance and Audit Act, 1983</i>, including the adoption of appropriate quality control practices.</p> <p>Performance reviews provide a limited level of assurance and a negatively expressed conclusion. In comparison, performance audits provide a higher level of assurance and a positively expressed conclusion. Performance reviews are generally more limited in scope than performance audits, and rely on lesser levels of evidence, such as making limited enquiries and examining smaller samples of data, documents, transactions and events.</p>
<b>Acknowledgement</b>	We gratefully acknowledge the co-operation and assistance provided by the NSW Treasury and the advisers involved in the Sale Transaction.
<b>Team</b>	Our team leader for this performance review was Chris Giumelli, who was assisted by David Daniels. Tony Whitfield provided direction and quality assurance.
<b>Cost</b>	Including staff costs, printing costs and overheads the estimated cost of the review is \$90,000.

## Appendix 2 Letter from NSW Treasurer



NEW SOUTH WALES

TREASURER  
MINISTER FOR STATE AND REGIONAL DEVELOPMENT  
SPECIAL MINISTER OF STATE



Mr Peter Achterstraat  
Auditor-General  
The Audit Office of New South Wales  
GPO Box 12  
SYDNEY NSW 2001

Contact: Nicholas McBride  
Telephone: (02) 9228 3535  
Your Reference: D1017642

Dear Mr Achterstraat

I refer to your recent letter requesting information regarding the NSW Lotteries transaction. My apologies, but given that your request coincided with the finalisation of the State Budget I was unable to respond within the requested timeframe.

The governance and probity requirements for the Government's business asset transactions were approved by the Budget Committee of Cabinet in December 2008. In accordance with these requirements the NSW Lotteries transaction was overseen by a Steering Committee comprising senior officers from Treasury, the Department of Premier and Cabinet and Communities NSW. The Steering Committee was assisted by leading, specialist financial, legal, accounting & tax, probity and communications advisers (Goldman Sachs JBWere, Gilbert + Tobin, Ernst & Young, RSM Bird Cameron and Kreab Gavin Anderson respectively) and several working groups.

The Steering Committee gave me status reports during the course of the transaction and advised me and the Minister for Gaming and Racing on the exercise of our functions under the *NSW Lotteries (Authorised Transaction) Act 2009* and the *Public Lotteries Act 1996*.

The day-to-day activities associated with the transaction were handled by the Steering Committee, project advisers and working groups. I was not in any way involved in the communications with proponents, including communications in relation to unclaimed prizes.

However, I have made enquiries of Treasury and through them and the project advisers have been advised that:

- Treasury officers made no representations or statements to proponents in relation to unclaimed prizes
- All proponents were provided the same written information and consistent information generally in relation to unclaimed prizes

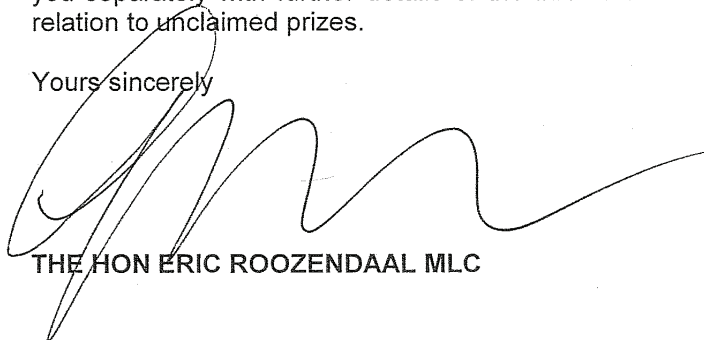
Level 36, Governor Macquarie Tower, 1 Farrer Place, Sydney NSW 2000  
Tel: (02) 9228 3535 Fax: (02) 9228 4469

- No proponent was told categorically by project advisers that unclaimed prizes would be transferred to the Government
- No proponent was told by project advisers that unclaimed prizes could not be included in their offer
- All proponents were informed through the Q&A process that the intention of the State was to transfer unclaimed prizes to the Consolidated Fund, and that this was clearly a statement of intention not a categorical statement of the Minister for Gaming and Racing's or my position
- All communications with proponents by project advisers took place in circumstances where each proponent was told and acknowledged that project advisers had no authority to bind or speak for the State and, in particular, that to the extent any aspect of the transaction involved the exercise of a Ministerial discretion, it was not possible to fetter that discretion or give any comfort or assurance in relation to its exercise
- A decision to transfer unclaimed prizes to the State involves the exercise of discretion by both the Treasurer and the Minister for Gaming and Racing
- All communication with proponents took place in the context of a confidentiality and process deed that made it clear that proponents could not rely on any statement by or on behalf of the State during the process.

I am satisfied that the transaction process was conducted fairly and in accordance with probity principles (as confirmed by RSM Bird Cameron's unqualified probity report) and that the Government received fair value for the future unclaimed prize stream.

I understand that your team has discussed the transaction process with relevant people from Treasury, Goldman Sachs JBWere and Gilbert + Tobin and that Treasury is writing to you separately with further details of the information that was provided to proponents in relation to unclaimed prizes.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Eric Roozendaal', written over a large, faint circular watermark or stamp.

**THE HON ERIC ROOZENDAAL MLC**