

Re: The Horserace Betting Levy Board

OTTON III

Consultant's Advice

to the Horserace Betting Levy Board

(Final Version)

by:

Rt. Hon. Sir Philip Otton

19 December 2008

Introduction

1. I am, of course, delighted that the parties were able to reach an agreement for the 48th Levy. It was a great pleasure to be able to take part in the process. I would like to record my appreciation and gratitude to all the parties involved. Each party advanced its case with force and clarity yet did so in a patient, courteous and civilised manner. This is not always so in similar circumstances!!
2. It often happens in commercial mediations that although the immediate outcome does not achieve a final accord the process produces a basis upon which the final agreement can be reached. I believe that this was so in our case, thus making the mediation a well worthwhile step.
3. I wish to assure all concerned that whatever was said or proposed, or whatever document was relied upon by any party before or during the mediation process was upon a 'without prejudice' basis and it is still bound by the Confidentiality Clause which the parties (and I) signed.
4. This Report follows the discussion I have had with each of the parties since 31 October. I again thank all concerned for their cooperation and assistance and the pleasant and constructive atmosphere in which the discussion were conducted.
5. The Advice is an extension of that which I gave on 13 October (and its supplement). I again emphasize that what follows is not legal advice, still less a Judgment or an Arbitral Award. It is an attempt to assist all parties (including the Government-appointed Members) on the Levy Board to move matters onto the next stage on the basis of my own personal observations. I hope that this paper (at least in part) will assist all parties to that end.
6. As a result of the discussions and submissions since my earlier Advice some of my earlier conclusions have been modified and in some areas expanded.

Turf TV

7. This section must be read in conjunction with paragraphs 31 to 37 of my Advice dated 13 October 2008. I adhere to the view that the costs of Turf TV (and SIS) cannot be set off in whole or in part against the GP (see paragraph 36(1)). However the additional costs undoubtedly affects the 'capacity to pay'. I would expect on a future Determination that the Secretary of State will be prepared to accept in principle that the additional costs should be taken into account but confined to the capacity to pay.

8. Since my earlier advice I have had the opportunity to consider Project Anatis which is a report by KPMG who were asked to draw conclusions about key money flows in broadcast services to UK LBOs. They were asked to do so by the Levy Board and not by either of the parties. The report gives credence to the BC claim that the incremental cost of acquiring pictures is, indeed, in the order of £40m. It also concludes that the increase in rights payments to the tracks concerned is in the order of £9.6m per annum and, although the profit share dividends to the participating tracks has not been revealed, it is estimated to be between £3.6m and £6.6m per annum. If a median assessment is made, the study indicates an additional money flow to the participating tracks of between £14.5m and £15m per annum. These are substantial sums which justified BC advancing the argument that they should be taken into account. However, BHA refused to make any allowance on the capacity to pay.

9. BHA seek to demonstrate that any residual impact was the consequence of direct and indirect action by the betting industry's own collective organisation, BAGS. They further maintain that the impact of introducing a second picture service to LBOs is much lower than claimed by the BC. They have mounted an attack on the Project Anatis report and rely upon an analysis of the impact of SIS/Turf TV (Schedule 1) and the true loss in value of SIS product (Schedule 2). They submit that it is unreasonable for the Levy to be adjusted for any part of the increase in cost resulting in the increase in rights fees for any other products, whether greyhound racing, overseas racing, or otherwise. Consequently the headline costs in the report of £29,632,000 should be reduced to £17,232,000. They further contend that the Levy should not be reduced to take account of increases in

rights fees to British racecourses. Thus the estimated impact of the introduction of Turf TV should be further reduced by £9.6m. This produces a revised impact of £7,632,000.

10. There are two fundamental problems. The first is capable of resolution in the short term. At present the punter in an LBO is faced by two television screens (Turf TV and SIS). I have heard descriptions which are quite farcical. There can be an overlap of races and confusion over the odds with two spoken commentaries. This is undoubtedly unsatisfactory. I understand that Ladbrokes have made some progress in remedying the situation by operating a central studio in which the services are rationalised as far as possible and then transmitted to their LBOs. What is clearly needed is a common studio operated by Turf TV and SIS together in order to give a cohesive programme to all subscribers throughout the racing day. However, at present the two sides continue to fight each other and the Levy yield reduces as a result.
11. The other problem is much more substantial. It is unfortunate that the SIS service is financed by Bookmakers and Turf TV is an arrangement between a number of racecourses with other racing interests. Turf TV then charges Bookmakers.
12. I have come to the conclusion that it is inherently unlikely that any Committee set up to resolve this situation could do so 'in-house' if the committee is chaired by the Levy Board Chairman or CEO.
13. What is obviously required is a person of stature and experience in the broadcasting world brought in from outside. He/she could take this issue by the 'scruff of the neck' and force through a much better arrangement. He might persuade both parties to renegotiate their rates and charges. If funding is needed to instruct accountants or other consultants to assist this process it will be for the Board to decide how this will be done.
14. It has been suggested that if picture costs were restored to their original level plus RPI, BC might be attracted by a long term 10% deal and they might be persuaded to pay for 'free-to-air' pictures.

Gaming Machines and Virtual Racing

15. Racing claims that it should benefit from Bookmakers' other sources of income, notably from gaming machines and virtual racing.

16. In my Advice dated 13 October I identified the key passage in Section 27 (2) as:

“The effecting of betting transactions on horse races and only on such of the business as relates to such betting transactions.”

I excluded all other betting transactions, for example football and greyhound racing:

“If the draftsman had intended all sports to be taken into account he would have said so.”

I then considered the phrase

“...so much of the business as relates to such betting transactions...”.

I drew a distinction between ‘from’ or ‘derived from’ and stated that ‘as relates to’ was wider in concept and suggested that the phrase encompasses betting activities which establish a relationship or link between them and horseracing. So construed and with convincing evidence the Secretary of State was probably able to take account of other activities which do have a connection with horseracing (and not merely traditional horseracing). I then stated:

“I consider on the balance of probabilities that the SOS, if forced to make a Determination in the exercise of discretion is likely to take into account GP from FOBTs.”

17. Since then I have had the benefit of considering an Advice from Mr Pushinder Saini QC dated 20 October. He has stated at paragraph 6:

“Crucially, the provision by a Bookmaker to a punter of a FOBT as a service does not depend in any way on British horseracing and FOBT income does not depend on any particular British racing transaction.”

18. In an Advice dated 16 October Mr Kevin de Haan QC reiterated a view he had expressed in 1999:

“The golden thread running through the whole statutory framework...is that since these monies may only be applied for purposes beneficial to horseracing, Bookmakers should only be called upon to pay on the basis of their turnover derived from betting on horse races. Turnover derived from any other betting transactions is treated as irrelevant to the statutory scheme as it now exists.”

So far we appear to agree. In his later Advice he equates ‘as relates to’ with ‘directly derived from’ horseracing. I drew a distinction between these two expressions and I still consider it right to do so. He then considers refreshments and ATMs which I have never suggested are related. These cannot be said to have a connection with horseracing. The former is directly derived from hunger or thirst. The latter derives from a need for money. He reiterates the view that ‘it was most strongly arguable that the Secretary of State could not lawfully calculate the amount of the Levy on the basis of the GP derived from commercial activities other than horseracing.’

19. More to the point is his practical consideration that it would introduce an unacceptable element of uncertainty into the process of calculating the Levy. He poses the question (paragraph 2.6):

“How does the Secretary of State ascertain what is an appropriate figure for FOBT usage which is connected to horserace betting? Market research in this area is a very unruly horse indeed.”

This, to my mind, is a powerful argument and I return to it below.

20. On 28 October Lord Pannick QC gave an Opinion on behalf of the BHA that:

“(1) In deciding what rate of Levy to charge on leviable income...the Secretary of State...is entitled to take into account all of the income received by Bookmakers, from whatever source, whether or not it is related to betting transactions on horse races.

(2) The Levy may only be charged on so much of the business of the Bookmaker ‘as relates’ to betting transactions on horse races, which means to ‘have some connection with’.”

I have no difficulty with (2). It coincides with my suggestion regarding Section 27 (2) (a). I do have difficulty in regard to (1). First, (1) and (2) appear to contradict each other: (1) states that the Secretary of State is entitled to take into account all of the income derived by Bookmakers from whatever source; (2) states that the Levy may only be charged on so much of the business as relates to betting transactions on horse races.

Second, if (1) is correct, then income derived not only from gaming machines and virtual racing but also from football and greyhound racing and even politics is leviable. BHA has never cast its net so wide. Moreover, if (1) is correct then, logically, all of the Bookmakers’ expenses, from whatever source (e.g. Gaming Tax, etc) could be taken into account in assessing the Bookmakers’ capacity to pay.

At paragraph 20 he states:

“It is difficult to see how the Secretary of State could take account of the latter (prevailing economic conditions and other economic, fiscal and social circumstances) without having regard to the former (‘all income sources of Bookmakers’) since economic circumstances generally will inevitably have an impact on the general income of the Bookmakers.”

21. Lord Pannick at paragraph 23 deals with the ‘relates to’ question and states that these words do not confine the chargeable income to that directly received from bets placed on horse races. He continues:

“If Section 27 (2) (a) were intended to be confined to income ‘from’ betting transactions on horseracing...the Section...could and would have said so. To ‘relate to’ means to ‘have some connection with’. Sir Philip Otton reached the same conclusion.”

He then considers whether the income upon which the Levy is being charged has a connection with betting transactions on horse races. He then reiterates my suggestion that this is a matter of judgment for the Secretary of State who has the discretion as to the setting of the Levy. Later he states (paragraph 25):

“At any particular time, it is for the Secretary of State to consider and decide whether particular income satisfies the ‘relates to’ test.”

And in paragraph 26:

“In my opinion, if the Secretary of State is satisfied that a significant proportion of the income derived from FOBTs is the result of punters being attracted into betting shops to place bets on British horseracing then the Secretary of State would be entitled to conclude that such income ‘relates to’ betting transactions on horse races in that it is connected with such betting transactions. That was the conclusion reached by Sir Philip Otton...”

Suffice it to say that I still adhere to that part of my earlier Advice where it coincides with Lord Pannick’s Opinion (i.e. his (2)) whilst respectfully disagreeing with his conclusion (1).

22. The question now arises how, as a matter of practicality can the Secretary of State be satisfied that a significant proportion, and if so what, of the income from gaming machines is the result of punters being attracted into betting shops to place bets on British horseracing? I consider that Mr de Haan’s approach in this regard is impressive. It is within the Secretary of State’s discretion to assess the proportion but he could not hope to do so with any accuracy. He could adopt one of two courses. First, that it was too complex a problem and that he was not satisfied by Racing’s case. How could anyone (including the Secretary of State)

asses each punter's reasons for entering the LBOs? How can the Secretary of State differentiate between the football punter ('A') who plays the machines and the politics punter ('B') who also indulges? What about the person ('C') who enters to play the machines and then decides to bet on a football match and a race? The Secretary of State might well realise that he was in a minefield and elect not to exercise his discretion, an option which would be open to him.

23. Alternatively, he could grasp the nettle and make a rough guess. He is unlikely to say that 10% of the GP from gaming machines and virtual racing should be leviable. The best estimate of GP from gaming machines across the industry is thought to be of the order of £800m. 10% would provide a windfall to Racing beyond their wildest dreams. He could rely on the balloon (or petal) chart provided by the Bookmakers which purports to show (as I understand it) that 1% of visitors to LBOs place bets on horseracing and play the gaming machines. £8m would still be of immense value to Racing and it is possible that such a low percentage would not dent the GP from gaming machines unduly or meet with violent disapproval from Bookmakers' shareholders.

24. On the other hand Bookmakers may wish to challenge such a decision in the courts. If so they should bear in mind Mr Kevin de Haan's shrewd observation:

"Were the Secretary of State to determine the Levy by taking into account the Bookmakers' GP derived from activities other than horserace betting a judicial review would be likely to follow. That would in all probability have the immediate effect of delaying payment of the Levy. In the long-term it could be the final nail in the coffin of the Levy."

Mr Pushinder Saini makes a similar point:

"But such an approach (i.e. by the Secretary of State to include an element from gaming machines) is likely to call into question the legitimacy of the entire system of a forced subsidy under which the State requires one sector to provide to another in parallel to new commercial licensing arrangements."

Thus, if the Bookmakers want to go to the wire on this issue they may bring down the Levy Scheme entirely. This cannot be in the best interest of Racing and I suggest that it might still be wise for them to identify from whatever source they choose a sum in the region of (say) £4m without conceding the point (a 50/50 chance?).

25. On reflection I have come to the conclusion that the connection between horserace betting transactions and virtual racings (essentially a random numbers system) is so tenuous that it should be ignored.

26. In short, the primary issue (i.e. Lord Pannick (2)) could go either way. The arguments advanced by Mr Pushinder Saini and Mr Kevin de Haan make out a more convincing case than when the matter was first addressed. Their view that gaming machines and virtual racing are not related to horseracing may well prevail over that advanced by Lord Pannick in his Advice on the law and my personal (i.e. non-legal) thoughts on the matter which are given without responsibility.

Thresholds

27. Racing continue to advocate a total abolition of all thresholds. They contend that they lose £16m of Levy each year. Thresholds were introduced when horserace betting was one of two products in LBOs (the other presumably greyhound racing); now there are numerous products including FOBTs. In essence they contend that all betting products presently in LBOs should be taken into account and that there is no basis for the Levy bearing the full brunt of the thresholds. They suggest that the larger shops should pay more and so eliminate or substantially reduce the threshold. Alternatively the Secretary of State when making a Determination should eliminate or reduce the threshold. Racing acknowledge that if the thresholds are abolished this would inevitably lead to substantial reductions in the number of LBOs and in particular would be harmful to the Tote betting shops.

28. However BHA do not seem to realise that by reducing the number of shops the gross profit which flows from these shops would be lost and the Levy thereby

reduced. BC reject the suggestion that the larger companies should pay a larger percentage to alleviate the pressure on the smaller shops. This would not benefit the independent, small betting offices and would lead to unfair trading between two shops in the same locality. They suggest, however, that if the purpose of such a change is to change the 'origin of the capital' this would not be an issue. However they see the BHA argument as an attempt to force the BC to pay more and not merely a re-distribution.

29. There is some merit in the BHA argument. If the gross profit of a shop as a whole (i.e. from all the betting activities) were taken into account, it is difficult to see how the threshold can be sustained at its present level. On the other hand the threshold level must be common to LBOs of all sorts. I suggest that this matter is capable of further discussion in the larger context of trying to reach an accommodation between the parties in a two to three year deal which is envisaged.

Betting Exchanges and Overseas Operators

30. I had made it clear that the issue of Betting Exchanges should be removed from the agenda. This notwithstanding BHA produced 6 pages of argument out of their 14 page letter of 28 November 2008. Not surprisingly Betting Exchanges wish to respond. They appeared at the meeting with the BC but I assured Mr Martin Cruddace that the subject was 'off limits' and that he could reply in writing if he wished to do so and that this would be conveyed to the Minister and whatever Committee was considering the issue.

31. Similarly I have not revisited the issue of Overseas Operators. I find it increasingly difficult to justify the imposition of the UK Levy on overseas bets particularly if they are subject to Levy in the country where they are placed (e.g. Ireland).

Overseas Racing

32. Until 2002 bets placed in the UK on foreign races were leviable. When the Secretary of State made her Determination she set the threshold at and above which the headline Levy rate of 10% was payable at £150,000.

33. BC contend that this was a time of transition to the British Horseracing Board licensing system and, as part of that process, the terms and conditions of the 42nd Scheme were designed by agreement to 'mirror' the terms and conditions of the BHB's licensing scheme. BHB had no rights over foreign racing and thus no basis upon which to claim a license-based payment associated with it. Foreign Racing was therefore dropped from the Levy and discontinued because foreign racing was beyond the jurisdiction of the license and there was no right to income from this source. In recognition of this, the threshold was halved to £75,000 and it remained unchanged until the 45th Levy Scheme when RPI increases were reintroduced.

34. Since then Bookmakers have negotiated fresh commercial contracts with providers of overseas racing such as France Galop, Horseracing Ireland and others for the rights to show their products in LBOs. The product is therefore bought and paid for via commercial arrangements either with the content provider (SIS or Turf TV) or directly with the governing body. The suggested mechanism at the time was that foreign racing was to be 'zero-rated' for the purposes of the Levy. Subsequently no reference was made to foreign racing and the Schemes thereafter referred only to British Horseracing Business. Thus BC argue that there is no logic to justify why the profits from a product which is properly and commercially acquired from racing authorities elsewhere should be leviable for the purposes of supporting British horseracing, particularly now that British horseracing has been more than adequately recompensed for the loss of the Levy income from foreign racing by the halving of the threshold on profits generated by its own product. I asked what the situation would have been had there been no such arrangements whereby the threshold Levy was halved. Starting with a threshold of £150,000 as determined by the Secretary of State, then increased by RPI, the threshold would, under the 48th Scheme have been set at £187,300. The actual figure was agreed at £90,000. BC's estimate of GP from foreign racing is about £140m per year. Given the Levy Board estimate that Levy yield decreases by £2.5m for every £10,000 increase in the threshold the Levy would be £23.3m less than it is now. Given an effective Levy rate of 9.5% across the board this would yield about £13.3m in extra Levy thus leaving a net £10m deficit had the previous arrangements applied.

35. Racing rejects the concept of a 'deal' with Racing to end the Levy on overseas racing. Moreover they do not accept in principle that Racing's acquiescence to exclude the Levy from overseas racing constitutes a 'deal' which should, or can, restrict subsequent Schemes. The Levy is a statutory Scheme agreed on an annual basis. Their view is that the income received by Bookmakers from overseas racing *must* be leviable. Section 27(2)(a) unambiguously provides that the Levy is payable on any part of a Bookmakers' business which 'relates to' betting transactions on horse races. No distinction is drawn in the 1963 Act between betting transactions on races which take place in Great Britain or elsewhere.
36. I have come to the conclusion that this is a very complex issue and one which I am unable to resolve. I recommend that the Levy Board should seek independent legal advice having regard to the submissions laid before the Secretary of State in 2002 and the agreements upon which BC seek to rely.
37. I venture the view (apart from the contractual argument) that it may be immaterial to a punter where a race is run. If he lives in Dover he might be more interested in a race in Deauville than in Newcastle. If he lives in Glasgow he might be more inclined to bet on a horse running at Dundalk than at Exeter. In both cases he still lays his bet in Sterling (and not in Euros) and in a LBO in Britain. If he wins, he is paid in Sterling by a British Bookmaker. There can be no Levy entitlement to the country where the race is run. There is no logic why such bets should not be leviable – BUT FOR the alleged contractual arrangements. If Racing's argument that the Statute overrides the contractual arrangement is valid then it would be logical to reinstate the higher threshold rate in favour of the Bookmakers. Racing, on the other hand, must be careful that if the threshold rises they may suffer a shortfall. It would appear that this issue is capable of some negotiated or mediated arrangement between the parties.

Uncollected winnings

38. Each year the Bookmakers retain the uncollected winnings. This would appear to be a 'windfall' for the Bookmakers. I suggest that an investigation should be carried out by the Government appointed members of the Levy Board as to how

much these are and what proportion or percentage could be fairly attributed to winnings on bets placed on horse races. BC may wish to consider making a charitable donation towards affordable housing for low-paid staff in the Racing industry.

48hr Declarations

39. The BC have provided detailed reasons why this policy is unhelpful to and unpopular with LBO customers. They have not provided an accurate assessment of the amount of loss to GP (and thus the Levy). They have been able to quantify the incidence of non-runners in the period August 2006 to October 2008 which varies from 9.9 to 15.5. The impact is more apparent in the increasing number of races with less than 8 runners, where the proportion of non-runners is higher.
40. Racing correctly state that '48hr Declarations are a Rule of Racing' which regulate declarations, entries, etc. Any decision regarding 48hr Declarations rests exclusively with Racing and neither the Levy Board nor BC have any say in the matter. They contend that multiple bets are a small proportion of betting behaviour and that 90% of all betting is done in the last hour before the race. BC may wish to challenge this last assertion.
41. However it must be borne in mind that:
- a. Due to the increasing numbers (albeit slowly) of foreign horses competing in British races it might be difficult to revert to a 24hr regime.
 - b. Most of the other major racing countries in the world operate a 48hr regime (Australia allows five days), but it must be recognised that 24hr Declarations are desirable for British Racing where the 'going' is much more likely to change due to changing weather conditions than in other parts of the world.
 - c. Operating a 24hr period for British horses and 48hr period for foreign horses would not work and would benefit British owners and trainers disproportionately.
 - d. 'Reserves' was tried at Ascot, found to be unsatisfactory and subsequently abandoned.

42. Although some trainers would welcome the restoration of 24hr Declarations, I am not persuaded by the BC's case for resorting to 24hr Declarations. In any event the best estimate BC can give is that the identifiable overall adverse effect on the Levy is unlikely to exceed £500,000 per annum. Racing should be prepared to give details of the potential financial loss from foreign competitors if there were to be a reversion.

The Donoughue Report

43. In 'Future Funding of Racing Review Group Phase 3 Report' Lord Donoughue and his Committee reviewed the current Levy legislation and identified such amendments as are needed to improve its operation.

44. In Part 2 they proposed an amendment to the existing legislation to provide a more flexible formulation which preserves the basic statutory concept but allows it to be extended in a legally sustainable fashion with the mutual consent of those involved while permitting an extension of the 12 month period for the duration of the Levy subject to force majeure.

45. I suggest that it would still be possible within the existing legislation for the Levy Board to reach an agreement for a period of say, two to five years. At an anniversary of the agreement, the BC would formally recommend the level for the following year and the LB would formally adopt. This would not impinge on the Secretary of State's power of Determination.

46. In the last sentence of paragraph 2.3 it is stated

"This agreement would, of course, have been vulnerable to challenge in law, something much more likely now without a statutory basis."

The possibility exists but is so remote that the idea of an extended period of agreement is justified.

47. I offer no view on whether the Levy year should match the calendar year save that it would not be possible to do so within the existing legislation.

48. More important, are the proposals regarding Dispute Resolution. In Part 3 paragraphs 3.4 and 3.5 several proposals are considered, such as independent mediation, advisory arbitration or binding arbitration 'as an alternative to Determination by the SOS'. The Committee correctly reject the suggestions on the basis:

"The Secretary of State cannot avoid responsibility for determining a Levy Scheme when this becomes necessary. This conclusion renders an independent arbitration process inappropriate and we therefore recommend no change to the current legislation in this respect."

49. However, it will be apparent that my proposals for a non-binding Arbitration process do not totally accord with the Donoghue approach. If the arbitration process which I propose were adopted it would not divest the SOS of his responsibility. He would still be required to make a Determination in the absence of an agreement.

50. Paragraph 3.4 proposes "a more consultative approach to the annual process informed, where necessary, by independent advice" and set out a timetable. I agree that the:

"...proposed procedure would have the added advantage that it would address Racing's long-held view that the Levy machinery favours the Bookmakers because they alone have the statutory right and obligation to propose the annual Levy Scheme."

51. My principal observation is that if an arbitral process is to be adopted rather than 'a consultative approach' the timetable is too tight to enable a tribunal to agree its Terms of Reference, to receive submissions, to pursue a consultation process with the parties, to explore in depth the issues and to decide and to produce realistic written recommendations to the Levy Board. I recommend an extra month should be allowed for this part of the process.

52. I support the idea that Racing should commence the process by submitting 'to the Bookmakers' Committee its view on the next Scheme, illustrating them by reference to specific objectives.' I would add, an itemised Business Plan with costings should be required as in a commercial context. The BC would then be required to consider and respond in detail to the Business Plan and then make a realistic recommendation to the Levy Board, who would then decide whether to accept the recommendation or to invoke the tribunal process.

53. Part 4 deals with representations on the Board. I have no contribution to make.

The future of the Levy in the Short Term

54. There are two processes working simultaneously. The first, is to find a medium term arrangement between the Bookmakers and Racing within the current Levy arrangements. The aim is to secure a deal of between 3-5 years, which, if agreed could take matters forward until, say 2012/2013 when picture rights are due to be renewed. This process is known as 'Group 2' and is chaired by the Levy Board's CEO Douglas Erskine-Crum. This has not given rise and should not give rise to any conflict of interest and the parties are content to proceed in this manner. Although the remit of Group 2 has been subsumed into other negotiations progress is reported. In the longer term a viable commercial replacement of the Levy is under consideration but as yet has not been identified. When it is, it will require legislation to bring it into effect. Both sides must accept that it is unlikely for this to be achieved within at least three years. I return to this aspect at paragraph 87.

55. It is therefore essential to try and improve the present arrangements within the existing legislative framework. All parties must realise that it was 'touch and go' whether an agreement would have been reached by 31 October 2008. The principal reason why an agreement was arrived at was the BC recommendation for a 'rollover' on the condition that Racing reinstated four Sunday fixtures and provided 104 additional races. Racing did not recognise BC's case for some discount based on Turf TV.

Procedural Changes

56. There are inherent procedural weaknesses in the present method of setting the Levy by agreement. The initial recommendation comes from BC. Inevitably they pitch their recommendation as low as they can (say £60m). Racing then responds with its statement of needs which they pitch as high as they think they reasonably can (£135m plus). Negotiations can take place. In the absence of agreement there is then stalemate. Thus even if Racing and the government appointed members agree on what they consider to be a fair and equitable Levy they cannot set such a Levy in the face of the refusal of the BC to recommend it (the veto). In this event it is inevitable that the matter goes to the Secretary of State for Determination.
57. This situation will become increasingly more unsatisfactory. Racing contend that the needs of Racing have increased, and the intransigence of BC more apparent. In the current economic crisis the situation is likely to deteriorate further. Mr Roy some months ago predicted that there would be a recession and in the press indicated what it would mean to him as a horserace owner. This situation will continue so long as Racing refuse to acknowledge the impact of Turf TV or that it should be taken into account in assessing the BC's capacity to pay and are so vague in detailing their needs specifically.
58. A future mediation process will face enormous difficulties. There will be a rerun of all the issues, i.e. gaming machines (FOBTs), thresholds, 48hr Declarations, etc and the process is unlikely to achieve a consensus.
59. Mr Robert Hughes, Chairman of the Levy Board, has floated the idea of non-binding arbitration. This is not a contradiction in terms. I have given it further consideration and conclude that it could work in the following circumstances.
60. Instead of the Bookmakers making their initial recommendation the first move should be by Racing. They should state with full particularisation their needs and documentation in support. This could take the form of a properly reasoned and presented Business Case. The next stage would be for BC to consider this case in depth, critique it and to make proposals from their perspective. If Racing

disagreed they could then put forward their counterproposal. If the Levy Board thought that the prospect of agreement with or without mediation would not be possible they should have the power to refer the matter to an Arbitral Panel or Tribunal. The Tribunal would then report and make a recommendation to the Levy Board as to what the level of Levy should be.

61. If both parties (and the government appointed members of the Levy Board) accept the Tribunal's recommendations the BC would then recommend their agreement to the Levy Board who would then accept the recommendation and set the Levy.
62. If BC rejected and declined to make any recommendation (i.e. exercising their veto) it would then go to the Secretary of State. In the meantime a mediation process could be invoked with a view to a negotiated settlement before the deadline date.
63. There would be an added process through arbitration which would not be binding because they would only make decisions and make a recommendation. The advantage would be that if it were to go to Determination the Secretary of State would realise that the Levy Board had done all in its power to facilitate an agreement and that the matter had come before him as a last resort and not as an easy option which it is currently perceived to be. He would also have the advantage of the Tribunal's findings and recommendations. This would make his task easier and he could accept the recommendation in whole or in part and reach his own, better-informed Determination.
64. It is axiomatic that the Tribunal should be independent. It should have a former Judge or QC as its Chairman and an accountant and a person of commercial experience outside Racing. The Tribunal should have the power to commission independent experts at the Levy Board's expense. It would hear one day of legal argument by advocates on such issues as the interpretation of Section 27(2) and gaming machines.
65. The tribunal members should already be identified after consultation with DCMS and be available immediately to commence the arbitral process by giving its

Directions as to dates for submissions, hearings, etc. The Report should be available for a Board Meeting towards the end of September. This would still allow discussions or mediations to follow before 31 October deadline.

66. It would be up to the Levy Board to determine whether they accepted or rejected the recommendation. Either party might seek to challenge the decision of the Levy Board (but not of the independent Tribunal itself who only make recommendations). Later either party could challenge the decision of the Secretary of State in the courts. Any challenge would probably be by way of Judicial Review with an essential feature being that the challenge would have to be made expeditiously.

67. This part of the Advice must be read in conjunction with my Comments under the heading 'The Donoghue Report'.

Racing and Bookmakers

68. Both Racing and Bookmakers have a joint interest in the continuing prosperity and development of British horseracing. They are joined at the hip. Yet, unfortunately, they adopt an adversarial, even acrimonious approach to their common aim. A vibrant Racing industry produces more Bookmakers' GP. A weakened Racing industry depresses Bookmakers' GP. Depressed GP means less support for Racing from Bookmakers.

69. The time has come (and is indeed overdue) for both industries to take stock and examine ways in which they can contribute more effectively to the good of Racing.

70. For Bookmakers the near future is distinctly unpromising. JP Morgan have recently carried out an analysis following the publication of Ladbrokes most recent results. They forecast that over-the-counter earnings will decline by 4% against their previous forecast of a level performance through 2009, that telephone sales will continue to decline and that internet sales growth will slow from about 19% this year to 11% next. Overall trading profit is forecast to reduce from an estimated £296,500,000 at the end December 2008 to £204,400,000 by

the end of 2009. This company is in a relatively strong position compared with many other Bookmakers who will face an even more difficult year. One can safely predict that this downturn will be common to the industry as a whole.

71. Racing on the other hand, remains relatively strong. There have been no racecourse closures for many years, new racecourses have been opened this year and BHA Chief Executive has gone on record as saying:

“Even allowing for the prevailing economic conditions, the sport is in rude health”.

72. This apparent fortunate situation is undoubtedly due in part to the underpinning of the Racing industry by the Levy. However it is a fact that the horserace betting in LBOs is now seriously challenged by betting on football and even politics.

73. There are two perceptions which must be addressed. Racing believe that Bookmakers regard their industry as ‘Bookmaker fodder’. Bookmakers have an unappeased appetite for more fixtures and more races which Racing (i.e. the industry) are required to satisfy. Mr Paul Dixon has gone on record as saying:

“Most of the additional costs of moulding Racing to suit Bookmakers falls on owners and trainers”.

74. Bookmakers, for their part, consider that Racing regards and treats Bookmakers as a ‘money milch cow’ with its ever-increasing demands for more Levy which Racing regards as its right.

75. Both attitudes are stultifying and must change. Both parties must explore in depth how they can work together to improve British Racing. I make some suggestions which I acknowledge might not be palatable.

Racing

76. The time has come for Racing to adopt a more cohesive and commercial attitude. The interests of Racing are diverse and include racecourses, owners and could be more unified into one industry based on the concept of a modern, commercial

entity and as if they were responsible to a body of shareholders. Racing as one whole could begin by addressing the Bookmakers' demands for more 'betting orientated products' i.e. more race meetings and more races. It is up to the Racing industry to assess the costs to them of each proposal. For example if it costs the industry as a whole, say £60,000 for a new race meeting they should establish, by demanding from the Bookmaking industry what they predict the GP will be if the project goes ahead. If, say, this was £40,000, then only £4,000 goes to the Levy and £36,000 to the Bookmakers. The additional cost falls on the Racing industry and if it is manifestly disproportionate to the benefit of the Racing industry, the proposal should be turned down. A similar exercise should be carried in respect of the BC's demands for more races in the same racing fixtures. This leads me to suggest the Racing and Bookmaking industries should combine their efforts to producing a business model.

77. There should be an annual Business Case as to what the Racing industry intends to achieve which should be available for all interested parties. A budget is not a sufficient substitute, nor is an out of date 'needs' list. This should include also a business case for the Levy Board's expenditure on the BHA.

78. They should consider the viability of unprofitable racecourses and whether or not they should continue to fund them. Some well known football clubs have gone into administration. This could happen to some racecourses. It is as likely to happen to training yards and studs, why not racecourses. Consideration should be given as to whether with or without the current level of Levy support they are commercially sustainable. This would lead to a consideration as to whether they should be allowed to go out of business and the Levy should be redirected to improve other racecourses. On the other hand some may think that the Levy itself is not sustainable without the contribution to Bookmakers from such courses.

79. With such a commercial approach it would be possible for Racing to consider extending the cards at the better performing racecourses which would attract more race goers and more Levy.

80. Although said many times previously Racing, like any other business, should consider whether it can improve its advertising, promoting and marketing of their product. There is room for improvement in pricing, presentation, quality of facilities and provision of information to name but a few. Could car parking fees be lower, could restaurant facilities be improved? What is the cost/benefit of 'Free Days'?

81. Consideration should also be given to imaginative methods of 'sweating the assets' of race courses.

Bookmakers

82. The Bookmaking industry for their part should cooperate with the Racing industry in assessing the commercial benefit from their demands for more races and fixtures and providing correct information for the Business Model. The attraction to the punter of winter-night races for poor quality horses may be more limited than from extended race cards at the better performing race courses.

83. The Bookmaking industry can still make LBOs more attractive and promote Racing better. The first and obvious one is to improve TV imaging – which I have dealt with elsewhere.

84. Is there any reason why either industry should not engage in a joint (or individual) advertising campaign? Why cannot jockeys appear in a TV advert saying that 'I shall be racing in Newbury next Saturday against other top-class jockeys, why don't you come and enjoy a spectacular day at the races?!' They should not of course mention the names of horses that they are riding or trainers or owners.

The Levy Board

85. There is room for the Levy Board to become much more commercial in its approach than it is. The Levy Board (and in particular its independent members) should for example consider whether it is commercially sound to make interest-free loans to build new racecourses. It should also consider the policy of supporting weaker courses.

86. I am sure others will have much more imaginative ideas once both industries start to come together and to cooperate for the common cause based on commercial considerations by both parties.

THE LONG TERM COMMERCIAL ARRANGEMENTS

87. The Bookmakers are keen to discontinue the present Levy Scheme. Although part of Racing is sympathetic to the idea if a suitable alternative can be found, some part of Racing (e.g. powerful racecourse groups) would like the Levy to continue.

88. A second process (to that referred to in paragraph 54 above) has been established to consider whether the present Levy Scheme should be replaced by a long term commercial arrangement and assumes that the Levy no longer exists. This is far more fundamental and far-reaching than the first process. Unfortunately, there have been no recent negotiations and the process has stalled. I must express my grave concern that any real progress is unlikely to emerge under the present regime. The Chairman and CEO of the Levy Board are likely to be viewed as having conflicts of interest.

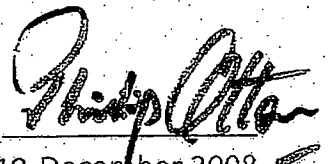
89. My recommendation is that an independent outsider should chair a small, high-level group of decision makers from the Racing and Bookmaking industries (and the Levy Board) in order to find, propose and progress a Long Term deal by 31 July 2009, if possible. However in reality this is likely to take longer.

90. It is essential that not only the Chair should be independent and impartial but also that his appointment should not be capable of being blocked by any of the interested parties. I suggest that some prestigious body be approached by the CEO to prepare a shortlist of recently retired high-powered Chairmen or Chief Executives of large commercial enterprises. The short list could then be submitted to the Secretary of State for him to select, appoint or invite the person to serve for an appropriate period.

Conclusion

91. I should be pleased to assist in progressing any of the above matters should the Levy Board consider that it might be helpful.

Sir Philip Otton



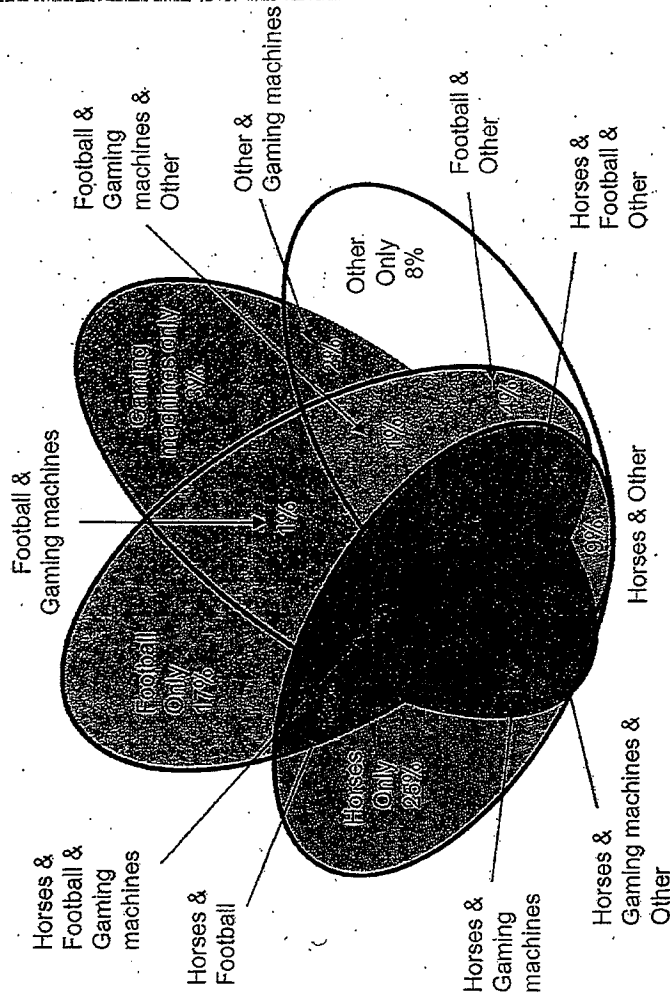
19 December 2008
20 Essex Street
London WC2R 3AL

Limited crossover between horse and other betting

Independent studies recently commissioned show that products in shops are complementary rather than substitute each other

The cross-fertilisation between the products is demonstrably very much a two way flow

Product crossover



Source: SPA Market Research