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Dear Paul

REVERSION TO TURNOVER-BASED LEVY SCHEME
– BOOKMAKERS' COMMITTEE RESPONSE

Further to my letter dated 22 Oct 10 in which I addressed, with one exception, the points raised by the Government Appointed Members (GAM) in their Independent Assessment (IA), I am now able to respond on behalf of the Bookmakers' Committee (BC), to the item outstanding and the paper submitted by Racing, 'Turnover Based Levy for the 50th Scheme'.

As you are aware, the BC recommended continuation of a Gross Profits (GP) based scheme which has now been in place for nine years and has served Racing well during that period. This is, in our view, the most appropriate measure to use within a Levy mechanism and is a position which the BC will continue to hold. We note also that Racing appears to wish to disconnect the GP/Turnover (TO) discussion from a bookmakers capacity to pay; the Secretary of State (2002) and Deloitte LLP (2010) appear to disagree with Racing in that regard. I shall address Racing's paper later in this note.

In her Determination of the 41st Levy Scheme the Secretary of State said:

'I understand that the racing industry may be disappointed that I have decided to introduce a gross profits levy. But this is wholly consistent with the Government's introduction of a gross profits betting tax and is the fairest and most reliable indication of the bookmakers' capacity to pay.'

She also stated:

'Although all recent levy schemes have been based on turnover, it appears to me that, in current circumstances, it is not necessarily the fairest or most reliable indication of bookmakers' ability to pay the levy.'

We do not consider that any circumstances have changed since then to alter this view. For this reason, the BC considers that a return to a TO-based scheme would be open to challenge. Contrary to Racing's position, it is clear that the calculation of betting duty and levy are linked; the changes to General Betting Duty were introduced on 6 Oct 01 and were reflected in the BC submission for the 41st Levy Scheme which commenced on 1 Apr 02.

Current accounting standards recommend that bookmakers' 'true revenue' figure is effectively its GP and the concept of 'TO', as was originally used in previous Levy Schemes, is no longer used by bookmakers and it would not be reasonable to return to it.

One significant benefit arising from the switch to a GP regime for both tax and levy in 2001 was the immediate removal of the 'deduction', which of course benefitted punters and increased TO by reducing the price of a bet, thus allowing each £1 staked to last longer ('recycling') before it was bet to extinction. The reintroduction of a TO-based levy could result in the imposition of a new deduction; the decision whether to reintroduce a surcharge would rest with individual betting operators. This would likely impact most upon smaller shops, irrespective of who operated them. Some 'Big 3' shops at the bottom of the market would likely become unprofitable because they were charging no deduction and would close; small shops, which might want to charge a deduction but could not because of competitive pressures, would come under even more pressure and some would close. Therefore, even if no deduction were to be reintroduced, a number of shops would close and the collection-base for the Levy would shrink further.

You will be aware from my previous letter that the BC engaged RSBM to undertake modelling of certain scenarios to provide GAM further insight into the consequences of the imposition of certain types of scheme in the event that the recommendations of the BC are not accepted by the HBLB. Below is a précis of the data produced by RSBM within the report 'An Analysis of GB Horseracing Levy Scenarios, RSBM Ltd, October 2010' which addresses the following two scenarios:

- Imposition of a TO-based Scheme (1%) without abatements.

When compared against the 'Base' year:

- The 3 most vulnerable LBO groups would experience a reduction in average profits per shop of between 14% and 169%.
- It would be reasonable to assume that 50% of Single Shop operators, 20% of Large & Small Independents and 10% of B5 Very Small Shops would close.
- 422 shops would close.
- This in addition to the 72 shops expected to close under 'rollover' conditions.
- A total of 494 shops would close. (**Figure 1**)

Figure 1: Reduction in LBOs due to imposition of a TO-based Scheme without abatements

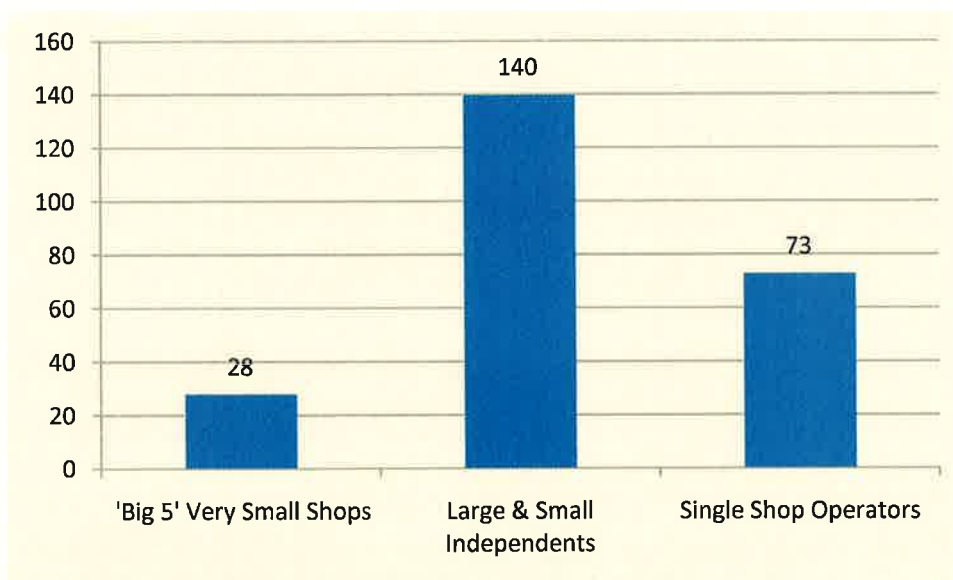


- Imposition of a TO-based Scheme (1.2%) with abatements.

When compared against the 'Base' year:

- The 3 most vulnerable LBO groups would experience a reduction in average profits per shop of between 7% and 108%.
- It would be reasonable to assume that 30% of Single Shop operators, 15% of Large & Small Independents and 2.5% of B5 Very Small Shops would close.
- 241 shops would close.
- This in addition to the 72 shops expected to close under 'rollover' conditions.
- A total of 313 shops would close. **(Figure 2)**

Figure 2: Reduction in LBOs due to imposition of a TO-based Scheme with abatements



If a deduction were to be imposed, the effect would be to make betting on racing more expensive, thus making it even less popular than it already is. It would also lead more punters to bet on line with firms based outside the UK who would be unaffected. There would be re-run of the situation 11 years ago when Victor Chandler first took his telephone business to Gibraltar in 1999. It would also be another incentive for those on-line providers still in the UK to 'take their business elsewhere'.

Moreover, any deduction would suppress TO liquidity because each £1 would bet to extinction more quickly (which is why TO went up 40% when the deduction was lifted in 2001). However, because of the much wider and more easily accessible tax and Levy-free alternatives which now exist, one would also expect to see the volume reduce as more punters switched platforms to avoid paying a new charge. This would make a bad situation worse for both Racing and traditional betting shops and would probably result in less income rather than more.

Bookmakers who employ business models based on giving more value to the customers will operate on a lower margin than other bookmakers. Therefore, even if a TO-based levy was not designed to raise more levy in total, the low margin businesses would be paying more proportionately. Within the LBO sector, the move would favour those shops with higher margins against those who give more away to customers. The natural consequence of this would be for bookmakers' to increase their margins in their levy paying businesses. They would, most likely, have different prices in their betting shops from their offshore telephone and internet businesses and, as customers like 'value', their natural tendency (likely to be encouraged by bookmakers) would be to bet on other products where the margins were better and there is

no levy to pay. It is not beyond the imagination for bookmakers to provide internet terminals in their shops with free access for customers to their offshore internet sites should they wish to avoid paying the deduction.

Remote businesses always operate to lower margins than retail ('best odds guaranteed' available everywhere online and telephone, but not in shops). Published accounts show for example, Paddy Power gross margin UK sportsbook retail 2009 - 11.6%, online sportsbook 6.9%; Ladbrokes gross margin UK sportsbook retail 2009 - 15.9%, online sportsbook 6.5%. Of course these are total sportsbook, not just horseracing, where the margin was probably lower.

It is disappointing that Racing, once again defines much of its argument around what it believes to be 'fair' and that of 'target yield' rather than take the opportunity to present a paper in which the merits or otherwise of GP and TO-based schemes are examined. It is the view of the BC that Racing, due to the extra revenues it receives through media rights, is currently in receipt of funds from bookmakers that by any measure are far in excess of 'fair'; a point reflected in the BC recommendations for the 50th Levy Scheme.

The GP based scheme is, without question, and despite Racing's assertion to the contrary, the 'fairest' way for Levy to be generated.

There is no logic to Racing's approach in seeking to use as a basis for developing its argument, a yield, whether single figure or range; to do so is to attempt to re-define the whole basis of the Levy and undermines the credibility of any Racing submission. That Racing aims to utilise an argument of 'best practice' is ridiculous; clearly no 'best practice' exists for dealing with target yield ranges as this has never previously occurred. Such an approach is both unreasonable and irrational.

Racing's paper states, correctly in our view, that there are no provisions in any applicable act which would prevent the levy returning to a TO-based scheme. However, it would be for the Secretary of State to impose a reversion to a TO-based scheme. The BC has throughout the current process, stated clearly its position on the imposition of a TO-based scheme; Racing's reference to this as a 'threat' is therefore disappointing. It is our position that a return through Determination to a TO-based scheme would be unreasonable on the basis that bookmakers have a legitimate expectation that the Secretary of State would abide by the original change unless there is a material change of circumstance.

Racing's argument relies heavily on its assessment that a TO-based scheme would reflect more appropriately, the popularity of racing. Even if this notion were to be proved correct, which the BC considers unlikely, there is no connection between the supposed popularity of racing and the capacity to pay and needs of Racing, the latter being the central considerations for determining any levy.

Racing's reference to commercial radio is irrelevant. Licence fees in the world of commercial radio are clearly payments for a product; the Levy is not a licence fee and this analogy is inappropriate.

No reference exists within the relevant determination which states that a GP-based scheme was not intended to 'last long'.

I remain unconvinced that Racing fully understands the implications of a TO-based scheme. If they did, they too would wish to retain a GP-based scheme. Even if competition determined that no shop imposed a deduction, the incentive to chase margin would remain; the sooner the customer loses the pound in his pocket, the less levy a bookmaker would pay – it is in the interests of Racing for the £1 to be recycled as often as possible.

Racing fails to recognise that it has to compete for 'the pound in the pocket', rather than simply be provided endless handouts. A TO scheme would provide no incentive or need for Racing to address its reducing relevance to the British betting customer.

I question also the suggestion by Racing that any material section of the betting public has the first idea that:

'the use of GP to generate levy means that Racing benefits the more its betting customers lose money.'

I consider this to be fanciful. At no time during the last 8 years has this been highlighted by press or public as 'an issue' within a GP-based levy scheme. It is ridiculous to suggest that it is suddenly 'unhelpful to the image and hence long term future of the sport.' Indeed, a TO-based scheme would work against customers as margins would have to increase.

Racing seeks to convince the reader that it can influence TO (or more specifically, we assume, increase it) when it can not do so with a GP scheme; this is not correct. Addressing the issues of 48 hour declarations and number of runners per race are but two areas, directly controlled by Racing, that would enhance GP and Levy return. That Racing chooses not to do so, due to commercial decisions it has taken, is a position of their own making. Levy is reduced as a result but bookmakers can not be expected rectify the effect of such decisions and compensate Racing for a situation it created.

The 'volatility' argument is also open to question. It does not necessarily follow that the fluctuations seen during the 48th Levy Scheme result because of a GP-based scheme; it is perhaps more likely that a failure in the calculation of forecasts either by individual bookmakers or the HBLB led to inaccuracies. As you are aware, the BC was not involved in the production of HBLB forecasts for the 48th Scheme.

Any reversion to a TO-based scheme would be extremely complex and would serve only to exacerbate the planning challenges currently experienced under a GP scheme. The BC acknowledges the challenges presented to the HBLB under a GP scheme but this is a management issue and should not be used as a driver to change the system extant. It is of note that the BC is assisting the HBLB to remove large fluctuations in its forecasting by providing up to date information for inclusion in HBLB's forecasting process.

I have little doubt that **every** remote business would be forced offshore if a TO-based scheme were to be imposed; even if the rate was not designed to increase the total Levy and in LBOs, bookmakers would either introduce a deduction or they would stop competing on price/offers; Racing would continue to lose market share.

Yours sincerely



WR **Will Roseff**
Chairman
For and on behalf of
The Bookmakers' Committee

28 Oct 10

Copy to: Douglas Erskine-Crum