Report for the Government Appointed Members of the Horserace Betting Levy Board

dated 19 October 2010

Deloitte LLP
Athene Place
66 Shoe Lane
London EC4A 3BQ

Report for the Government Appointed Members

of the Horserace Betting Levy Board

19 October 2010

CONTENTS PAGE

Report for the Government Appointed Members

of the Horserace Betting Levy Board

19 October 2010

APPENDICES

Report for the Government Appointed Members

of the Horserace Betting Levy Board

19 October 2010

ABBREVIATIONS USED IN THIS REPORT

Abbreviation	**Description**
GAMs	The Government Appointed Members of the Horserace Betting Levy Board
HBLB	Horserace Betting Levy Board
Racing	The constituents of British Horseracing as represented by the British Horseracing Authority, the Horsemen's Group and the Racecourse Association
BHA	British Horseracing Authority
RCA	Racecourse Association
Tote	Horserace Totalisator Board
Bookmakers' Committee	The Committee comprises representatives of the bookmaking and betting industry which recommends annually to the HBLB the categories, rates, conditions and definitions of the Levy Scheme for the following year.
Bookmaking interviews	Interviews with representatives (nominated by the Bookmakers' Committee) of Bookmaking
Racing interviews	Interviews with representatives (nominated by Racing) of Racing,
Tote interview	Interview with representatives (nominated by the Tote) of the Tote
LBO	Licensed betting office
FOBTs	Fixed odds betting terminals

1 INTRODUCTION, TERMS OF REFERENCE, WORK PERFORMED AND ITS LIMITATIONS

1.1 Deloitte LLP ("Deloitte UK", "we" and/or "us"), was commissioned by The Government Appointed Members ("GAMs") of the Horserace Betting Levy Board ("HBLB"), ("you") to provide assistance to you in your assessment of the submissions of Racing and the Bookmakers' Committee in relation to the 50th Levy Scheme. Specifically our terms of reference state that "*The consultants are required to, inter alia: comment on all submissions from Racing and the Bookmakers' Committee provided to the Horseracing Betting Levy Board in respect of the 50th Levy Scheme".*

1.2 Our terms of reference specifically exclude consideration of Betting Exchanges (other than including anticipated Betting Exchange Levy contributions in the analysis of possible outcomes for the 50th Levy) and Offshore Bookmaking operations since these subjects are both being currently the subjects of separate studies/consultation processes being carried out by the HBLB.

Structure of this report

1.3 This report is set out as follows:

- In the remainder of this section 1, we set out the background to our work, the limitations on the use of this report, the work performed and the limitations in the work we have performed;
- At section 2 of the report, we set out our Executive Summary;
- In the appendices we set out our analysis and observations on the submissions made to the HBLB in respect of the 50th Levy Scheme, scenarios modelling the potential yield of the 50th Levy Scheme and other observations.

Background to our work

1.4 The HBLB is the UK statutory body that was established by the Betting Levy Act 1961 and operates in accordance with the provisions of the Betting, Gaming and Lotteries Act 1963 (as amended).

1.5 The HBLB is charged with the duty of assessing and collecting monetary contributions in accordance with the formal annual Levy Scheme from Bookmakers and Horserace Totalisator Board ("the Tote") and distributing them for purposes conducive to any one or more of: the improvement of breeds of horses; the advancement or encouragement of veterinary science or veterinary education and the improvement of horseracing[1].

1.6 Each year, the Bookmakers' Committee formulates proposals for the next Levy Scheme in accordance with the Betting, Gaming and Lotteries Act 1963. It recommends the categories, rates, conditions and definitions of the Levy Scheme for the following year and then forwards them to the HBLB for consideration.

1.7 For the 50th Levy Scheme the process to be followed was altered whereby the HBLB invited Racing to present its proposals to the HBLB and invited the Bookmakers to respond to Racing's proposals, taking into account any comments from the GAMs and the Chairman of the Tote, in advance of the Bookmakers making their formal recommendations to the HBLB.

1.8 The HBLB takes into account the reasonable needs of Racing and the Bookmakers' capacity to pay levy before any agreement is made. As set out in our terms of reference, we are assisting the GAMs by commenting on all submissions from Racing and the Bookmakers' Committee provided to the Horserace Betting Levy Board in respect of the 50th Levy Scheme.

Limitations on the use of this report

1.9 We remind you of our Standard Terms of Business particularly in relation to confidentiality. These preclude you from disclosing this Report to any third party without our prior written consent.

1.10 This Report has been prepared for use by you. This Report is confidential and was prepared for the Purpose agreed between us. Save as set out below it should not be used, reproduced or circulated for any other purpose, in whole or in part, without our prior written consent. Deloitte UK accepts no responsibility

[1] As set out in the Betting, Gaming and Lotteries Act 1963

to any third parties for breach of this obligation or for any opinions expressed or information included within this Report.

1.11 We understand that you may wish to publish this Report in paper form or on your website and we give our consent to such publication. Deloitte UK, its partners and staff neither owe, nor accept, any duty of care to any other party than the HBLB and shall not be liable for any loss, damage or expense of whatsoever nature which is caused by such other party's reliance on representations in our Report. If you wish to publish this Report in anything other than its full and final form, you may only do so with our prior written consent.

Work Performed

1.12 In accordance with our terms of reference our work has comprised:

- Consultation with the GAMs and HBLB's executive officers;
- Review of documentation provided to us by the HBLB as identified by the HBLB and in response to our questions;
- Review of all the submissions provided to the HBLB made by the constituents of British Horseracing (collectively "Racing") as represented by the British Horseracing Authority ("BHA"), the Horsemen's Group and the Racecourse Association ("RCA");
- Review of all the submissions provided to the HBLB made by the Bookmakers' Committee;
- Interviews with representatives (nominated by the parties) of Racing, the Bookmakers' Committee and the Tote (respectively "Racing interviews", "Bookmakers' interviews" and "Tote interview"); and
- Reponses by Racing and the Bookmakers' Committee to questions asked by the GAMs, HBLB and ourselves.

1.13 We have not undertaken any independent detailed research or studies ourselves but have relied on the documentation provided by HBLB, Racing and the

Bookmakers' Committee. Significant revisions to the Bookmakers' Committee's financial analysis were submitted to the HBLB on 15 October 2010. We have reflected the amended numbers in our report where relevant. We have not, however, analysed the differences between the two reports.

1.14 We have assumed that the GAMs have read all the papers submitted by Racing and the Bookmakers and therefore have not summarised all the arguments and points made by both parties in this Report.

Limitations of the work performed

1.15 For the purposes of this Report, save where we have been able to corroborate information, we have had to assume that the documents or other information disclosed to us are reliable and complete. Our work was dependent on the co-operation of the people to whom we spoke and the completeness and integrity of the documentation that we reviewed. This report should be considered in that light and we cannot accept any liability for our findings being prejudiced through provision of incomplete or unreliable information or material.

2 REPORT

2.1 This Summary should be read in conjunction with the description of the work performed and its limitations, as set out in section 1, and our detailed findings as set out in appendices A to H.

2.2 We have set out the major features of the last nine Levy Schemes (being all those since the basis of the Levy changed from Turnover to Gross Win) in Appendix G.

2.3 The basis of the Levy has remained stable over the last eight Levy Schemes: there have been no changes in Levy rate, thresholds have moved in recent Schemes in line with inflation[2] and the basis of the Scheme has been settled by negotiation in seven of the eight years. The major change in landscape in 2009 and 2010 has been the movement of some 'big 3' Bookmakers' operations offshore[3]. We have taken account of the estimated likely effect of this change in our levy scenarios in Appendix E.

2.4 Both Racing and the Bookmakers' Committee argue that there should be significant changes for the 50th Levy.

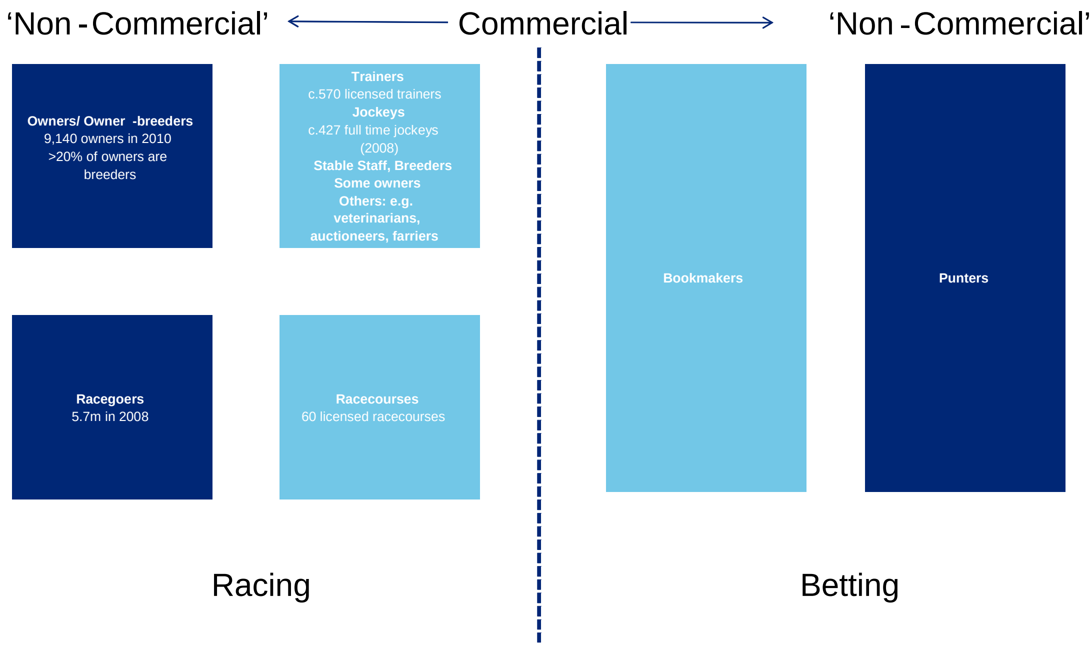
Overview – Appendix A

2.5 The constituent elements[4] of Racing and Bookmaking can broadly be categorised as:

[2] Between the 41st and 42nd Schemes thresholds halved and foreign racing was removed from the base of the Levy. The Bookmakers' Committee states that this was part of the agreement to the terms of the Levy Scheme whereas Racing states that it was not.

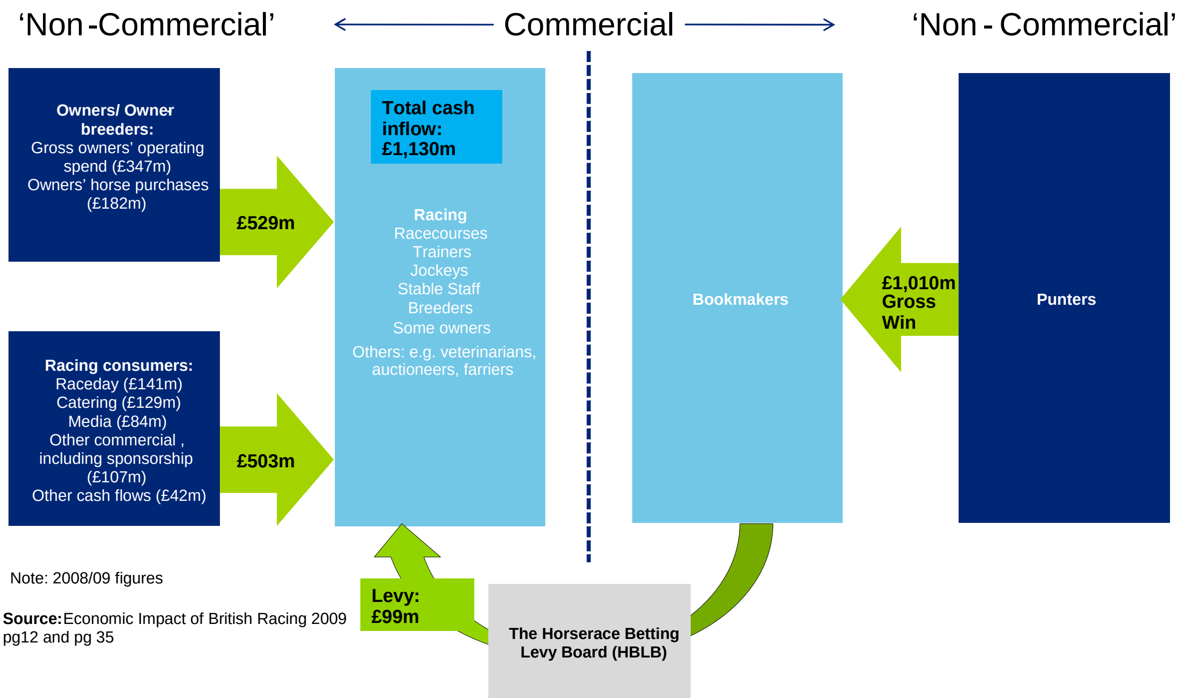
[3] The internet businesses of William Hill and Ladbrokes were levied for part of the 48th Scheme moving offshore in September 2009 and November 2009 respectively. The telephone business of William Hill was levied for all of the 48th Scheme and will be levied for part of the 49th Scheme. It is anticipated it will move offshore in Autumn 2010.

[4] All numbers are as of 2008 except for owners/owner-breeders for which we have 2010 data (as indicated).



2.6 Those elements whose motivation we have described as commercial are those who make all or the majority of their income from their involvement in Racing or Bookmaking.

2.7 The following chart overlays the principal cash flows between these categories:



Note: 2008/09 figures

Source: Economic Impact of British Racing 2009 pg12 and pg 35

2.8 This demonstrates that the majority of the cash funding both the Racing and Bookmaking industries receive is provided by individuals whose primary motivations are not commercial[5].

2.9 It is evident that Racing and Bookmaking have very different understandings of the purpose of the Levy and, indeed, both have provided more than one definition of its purpose.

2.10 Racing has argued that it is:

- A grant and not a payment for content or a service;
- It is not a subsidy or payment for a product; and
- It is a yield.

2.11 Bookmaking has argued that it is:

- Compensation for loss of attendance at racecourses;
- Not meant to be a subsidy but a transfer to help Racing help itself;
- Not a price for a product; and
- A mechanism not a yield.

2.12 The legislation[6] states the Levy is to be applied for:

- the improvement of breeds of horses;
- the advancement or encouragement of veterinary science or veterinary education; and
- the improvement of horse racing.

[5] By this we mean not that these individuals are not interested in the financial returns, but rather that if their investment in Racing or Bookmaking were evaluated rationally it would show that for the vast majority of them they receive back less than they spend.
[6] Betting, Gaming and Lotteries Act 1963.

2.13 During the passage of the Horserace Betting Levy Act 1969 a summary[7] of the then current arrangements was given as to what would be considered should the Levy Scheme have had to be determined by the GAMs[8]. These have developed into the present analysis which directs that account should be taken of[9]:

- All prevailing economic, fiscal and social circumstances as may relate to Betting and Racing;
- Betting's reasonable capacity to pay; and
- Racing's reasonable needs.

2.14 None of these terms is further defined either in the legislation[10] or otherwise.

2.15 There is a substantial gap between the Bookmakers' Committee's proposal for the 50th Levy Scheme (estimated yield £56 million to £64 million) and Racing's assessment of its reasonable needs (being £130 million to £150 million).

2.16 The challenge facing the GAMs is a complex one. They have to determine whether or not the proposed mechanism for transferring funds from Bookmaking to Racing is appropriate in circumstances where the other major financial providers to both industries are acting in a non-commercial way and where there is no clear practical definition of the criteria for making their decision. This problem is exacerbated for the 50th Levy by the substantial difference between the likely financial outcome of the Bookmakers' Committee proposals and Racing's quantification of its reasonable needs.

---

[7] Should a determination be required then the GAMs will *"......balance the needs of horseracing against the capacity of the bookmakers to pay*" (Hansard 28 January 1969 – Mr Morgan, Under-Secretary of State for the Home Department). This was then clarified such that "*we are aiming to determine not what the bookmakers are capable of paying but what it is reasonable for them to pay."* (Hansard 5 March 1969 – Mr Morgan).

[8] Mr Morgan went on to state "*It is only right that the Home Secretary should be given a much wider discretion. It is perfectly proper for him to take into account the ability of bookmakers to pay, to take into account the needs of the horseracing industry, and to take into account all manner of other considerations as well – the financial policies of the Government and wider social considerations."* (Hansard 28 January 1969).

[9] Letter from HBLB to Minister for Sport, DCMS, dated 30 April 2009.

[10] Mr Morgan stated *"......the expression which has been in statute since the Betting Levy Act, 1961, and now appears in Section 27(5) of the 1963 Act, is one which may well be incapable of definition. It has never been tested. What does the term "capacity to pay" mean? It may mean next to nothing at all. On the one hand, can one imagine a term more capable of an infinite variety of interpretations than "the needs of the horseracing industry"?* (Hansard 28 January 1969).

Racing's reasonable needs – Appendix B

2.17 Racing perceives its key risk in relation to the Levy to be the potential fall in prize money which, it argues, would result in owners / breeders taking their business to countries with higher prize money or ceasing or reducing their involvement with horseracing altogether. Although the Levy provides a relatively small proportion of the total funding received by Racing[11], it is a very significant provider in two areas - it provides over 50% of total prize money and funds all integrity and regulation costs.

2.18 In the period 2002 to 2008 racecourses experienced strong attendance averaging 5.9m per year, and over the last four years benefited from a rise in media rights payments. Collective racecourse profits were £16.8 million[12] on revenues of £456 million[13] in 2008. Several racecourses are however expecting a dip in revenues from corporate and private hospitality activities and a slight reduction in attendances this year.

2.19 The monthly average number of horses in training increased by around 9% between 2005 and 2010, the number of fixtures increased by 18% between 2002 and 2009 and prize money fell slightly from £116 million in 2004 to £111 million in 2009[14] in real terms.

2.20 In our opinion there are two main issues to consider when addressing Racing's funding from the Levy:

- What are Racing's reasonable needs? and
- To what extent should Racing's reasonable needs be funded by the Levy?

2.21 Consequently the consideration of the Levy requires an in-depth understanding of Racing's costs and its sources of income.

[11] 9% in 2008 and probably less currently.
[12] Racecourse Financial Performance, the Racecourse Association Limited (Schedule 1), 2008 data.
[13] Economic Impact of British Racing, 2009, page 21. Figure 11 - total revenue was £456m.
[14] Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B. The prize money data is adjusted for inflation per note 6: '*All amounts are restated up to 2009 using December RPI for each relevant year.*'

2.22 In relation to 'reasonable needs' there is no statutory, widely accepted or documented definition of 'reasonable needs,' or any clear definition in Racing's submission. Racing and Bookmaking's views are different and cannot be reconciled. Neither party addresses the extent to which those reasonable needs should be funded by the Levy.

2.23 Sir Philip Otton's view was that Racing should establish a business model based on the performance of the fixtures and create a business case for the needs of the Racing industry[15]. We agree with this suggestion and would add that the business case should be for all of Racing not just for some elements of the industry.

2.24 Racing has presented three methods to arrive at a 'reasonable' Levy yield:

Approach	50th Levy Reasonable Return
Racing's Needs	£133-152m
Reasonable Share of Benefits	£128-149m
Market	£121-151m (£154-184m including convoyed sales)
Racing's Final Reasonable Levy Yield	**£130-150m**

Source: 50th Horserace Betting Levy Scheme, Submission of British Horseracing[16]

These all fall within a relatively narrow range of £130 million to £150 million which Racing argues strengthens its case.

2.25 We note that the approaches taken are not predicated on the basis of assessing Racing's 'reasonable needs' as a whole but rather seek to estimate a required Levy yield in isolation. As a consequence Racing has not analysed in any detail around 87% of its costs and 90% of its income.

[15] Otton III Consultant's Advice to the Horserace Betting Levy Board (Final Version), by Rt. Hon. Sir Philip Otton, 19 December 2008, page 22, paragraph 77.
[16] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 3.

2.26 The table below summarises Racing's three methodologies and our main observations for each one:

Summary description	Key issues / observations
Racing's needs	
Racing uses a base of £90-£105m (the 41st Levy determination expected yield), applies cumulative inflation and additional costs for integrity, costs / compensation for additional leasehold fixtures and partial compensation for owners' transportation costs.	• The arguments for using the 41st Levy as a base are not persuasive; • There is limited evidence to support the increase in integrity costs; • Racing needs to conduct a fixture review to substantiate its assumptions on fixture-profitability and Levy generation[17]; and • The compensation for owners' transportation cost will not make a material difference to owners' total costs.
Reasonable share of benefits	
Using the 41st Levy determination expectation as a base, the following are then applied: • accumulated RPI (27%); • an increase in costs of 23.5%, based on the increase in the fixture list; • a 50% substitution effect.	• The arguments for using the 41st Levy as a base are not persuasive; • The 'substitution' rate of 50% is not substantiated by evidence; and • The average cost per fixture is assumed to be constant. We would expect that if the fixture expansion is efficiently managed, it should fall.
Market approach	
This method simulates a market negotiation between Racing and Bookmakers for a 'right to access racing for betting purposes.'	The key assumptions in this method are open to challenge because: • The 'product' that Racing is trying to sell is not the product Bookmakers want to buy; • The Levy is not a market mechanism; and • The London Economics' response shows that economic analysis of this sort is open to a wide range of interpretation.

[17] HBLB has detailed information on Levy generation by fixture but not on fixture profitability.

2.27 We set out our comments in detail in Appendix B. In summary these comments are to the effect that the key assumptions underlying the methods are open to challenge on a number of grounds including limited evidence and a lack of granularity of the data provided. We think it may be difficult, on the basis of the evidence and arguments put forward by Racing, for the GAMs to determine whether the amounts sought from the Levy are required to meet Racing's needs.

2.28 Racing's submission notes that British horseracing receives less income from Betting than horseracing does in other countries. It argues that this makes British horseracing less competitive for foreign owners and could result in owners / owner-breeders and trainers moving their operations overseas which would cause Racing to experience a serious decline.

2.29 We recognise that other countries do have different models for funding horseracing from the betting industry and agree that many of these raise substantially greater amounts in direct transfers than in the UK. Owners who run horses in the UK only receive a 23% return from prize money compared to 100% in Hong Kong or 55% in France[18]. However, given the very different models for the relationship between Betting and Racing in other countries, we do not consider a direct comparison between British horseracing and international racing can be made.

2.30 Falling Levy receipts may lead to owners, trainers and horses moving abroad and Racing has provided anecdotal evidence that some British horseracing activity may eventually be displaced. Racing has not, however, provided firm or quantifiable evidence to show the extent to which this displacement is happening or may occur in the future if the Levy does not achieve Racing's target. Further, the relative financial attraction of international racing has been a factor for many years and it is difficult to isolate the impact of a changing Levy from owners' other motivations in choosing where to race their horses.

2.31 A key theme underlying Racing's approach is its reliance on the determination of the 41st Levy as establishing a monetary value for the 'reasonable needs' of Racing and consequently uses it as a baseline for the 50th Levy Scheme.

[18] 50th Horserace Betting Levy Scheme, Submission of British Horseracing March 2010, page 48.

2.32 The Secretary of State's statement regarding the 41st Levy indicates that if the scheme as set out was applied to the Bookmakers' forecasts then the scheme would yield a Levy in the range £90m to £105m. It is not clear that the Secretary of State was suggesting that the stated range was a target for the Levy. Further, the actual yield would depend on the Bookmakers' actual profits and in the event the 41st Levy generated £79.9m.

2.33 We note that each Levy is set by reference to the circumstances relevant at that time and there is no doctrine of precedent which requires the practices of previous Levy schemes to be adopted.

2.34 Moreover, the circumstances surrounding the 41st Levy determination makes it a weak base for the 50th Levy. The 41st Levy negotiations were 'clouded' by negotiations over a commercial deal on data rights and it was expected to be abolished in 2002. Hence it may not be the most 'representative' Levy Scheme to use as a base[19].

2.35 The 47th Scheme which also went to determination but did not include any statement about potential yield is not referred to by Racing. Even if Levy Schemes previously determined by the Minister should carry greater weight than those settled by agreement, it is certainly questionable as to whether there is any basis for giving greater weight to the 41st Levy determination than the 47th Levy. Indeed, given that the 47th Levy determination is the more recent, the reverse may be the case.

2.36 We note that Racing assumes the Levy should fund all its specifically identified needs, particularly prize money and integrity and regulation. Racing's submission considers only the costs and provides no analysis of alternative revenue sources. We do not know, and Racing provides no analysis to show, whether owners could fund more (they provide around 47% of Racing's funding - £529 million) or whether racecourses could afford to pay more and / or fund integrity and regulation costs.

---

[19] British Horseracing Board, 41st Levy Scheme 2002/03: Memorandum to the Department for Culture, Media and Sport, November 2001, page 8 paragraph 1.3. '*The circumstances which led to the breakdown of the negotiations have been fully explained to DCMS... BHB does however take the opportunity to re-emphasise that the Bookmakers' Committee was only prepared to negotiate a levy settlement which was conditional on an agreement relating to pictures and data'.*

2.37 It is not possible, on the data provided, to determine the impact of a drop in Racing's income by 2% to 3% (£20 to £30 million) on the sport or the tipping point for, what Racing describes as the 'spiral of decline' for Racing.

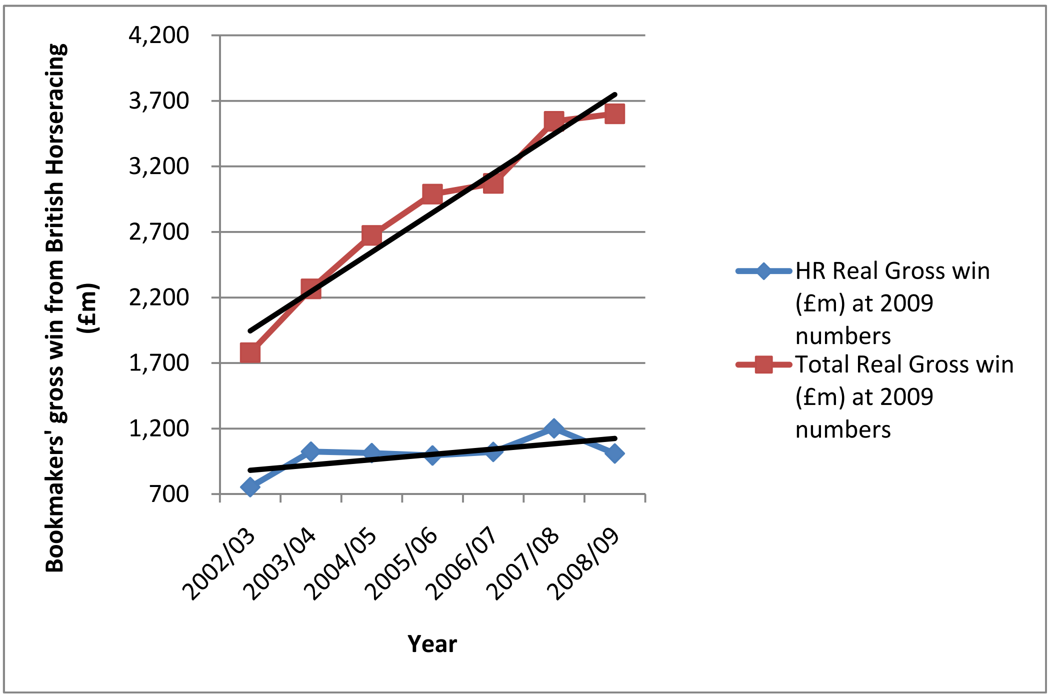
Bookmakers' capacity to pay and the mechanics of the Levy – Appendix C

2.38 In our view there are two issues to consider when assessing the Bookmakers' capacity to pay: (a) their overall capacity to pay and (b) the 'base' on which the Levy should be charged. We note however that both Racing and Bookmaking have, to some extent at least, treated these as a single issue.

2.39 Bookmakers have expressed the view that capacity to pay should be based on British horseracing gross win also taking account of media costs and the 'base' limited to British horserace betting. They have indicated that their capacity to pay has been reduced in the last five years by increasing costs; particularly media costs, Gambling Commission fees and compliance costs, rent, rates and marketing costs.

2.40 Bookmakers argue when assessing their capacity to pay (and the needs of Racing) the total contribution from Bookmaking to Racing must be considered, including media payments and sponsorship. The Bookmakers' Committee submission shows that Bookmakers' overall gross win has increased year on year from 2002 to 2008 dipping slightly in 2009. British horseracing gross win has remained essentially constant over the period[20].

[20] Although there was a significant increase between 2002/03 and 2003/04, there has been very little overall change since then.



2.41 Racing's view is that capacity to pay and the leviable base should be assessed on a wider range of Bookmakers' activities including foreign horseracing and FOBTs[21]. The inclusion of all LBO activities would increase the capacity to pay at a gross win level substantially, although we question how wide it would be appropriate to extend the base, particularly when some Bookmakers' operate diverse businesses that extend beyond 'pure bookmaking'[22].

2.42 Racing justifies this extension beyond British horseracing gross win by arguing that British horseracing is the anchor product which brings punters into LBOs and that it should thus receive an appropriate share of the profits made by Bookmakers from these activities. It calls this 'convoyed sales'. We do not consider the evidence to support this argument to be persuasive.

2.43 Racing further argues for the inclusion of foreign racing on the basis that it was included until the 41st Levy and that there is nothing in the legislation to limit the Levy to British horseracing. There may be some pragmatic advantages of including foreign racing within the Levy in regard to the organisation of the fixture lists, although Bookmakers argue that they are limited.

---

21 Fixed odds betting terminals.
22 For example, bingo halls.

2.44 Horses entered by Racing in foreign races[23] do not presently generate any Levy and it may be that British punters bet more heavily on these than other foreign races as they recognise the horses. It is however also the case that foreign trained horses run in Britain and betting on such horses placed in Britain will be captured within the existing Levy scope albeit the relative value of these amounts is not known.

2.45 Whatever base is taken, we do consider that the cost of media rights is a factor that affects Bookmakers' capacity to pay[24].

2.46 We note that Racing proposes a return to Levy based on turnover rather than gross win which it argues is more predictable, less subject to fluctuation and more within the influence of Racing. We consider that gross win is a better measure of Bookmakers' capacity to pay than turnover, albeit net profit or cash flow would be better still. However we recognise the difficulty in estimating such figures given the problems in the allocation of costs of bookmaking between betting products.

2.47 In our view Bookmakers have not demonstrated in their submission '*an incapacity'* to pay or provided any evidence that they could not pay more than proposed in their recommendations. The measurement of Bookmakers' capacity to pay is very dependent on whether that capacity is measured in relation to British horseracing or includes a wider definition of Bookmakers' profits.

---

[23] In other jurisdictions Levy is generated from betting on foreign racing.

[24] The Written Ministerial Statement for release on 20 February 2008 on the 47th Horserace Betting Levy Scheme states: "*Finally, turning to the issue of Turf TV, I accept that an argument can be put forward that bookmakers' subscriptions to the new service constitute a commercially-based flow of money to racing, albeit only from certain bookmakers to certain racecourses. I therefore accept that it may have a material effect both on bookmakers' ability to pay and on the needs of racing. However, it is apparent from the failure of the Bookmakers' Committee and the Levy Board to agree, and from the OCP report, that bookmakers and the racing industry hold widely divergent views on the status of Turf TV and the impact that it should have on the level of the Levy. In time its full economic impact on bookmakers, racecourses and on horse racing generally may become clearer. However, at this stage I consider that it would not be appropriate to take Turf TV into account in setting the level of the 47th Levy.*"

Impact of the economic, fiscal and social environment – Appendix D

2.48 Both Racing and Bookmaking have suffered and will continue to suffer through the economic downturn and are facing a similarly tough economic environment for the 50th Levy Scheme. The VAT increase on 4 January 2011 will impact both sides, leading either to higher gate prices at racecourses (which may impact attendances) or reduced margins (if racecourses choose to absorb the increase) and increased costs of additional irrecoverable VAT for Bookmakers.

2.49 We note that in recent years there have been no closures of racecourses (excepting Great Leighs – whose failure Bookmakers attribute to a flawed business model), although there have been job losses at racecourses and in other areas of Racing. Bookmakers have made regular shop closures, albeit there have been new shops opened too. Job losses within Racing tend to be less 'visible' in national media while Bookmakers, particularly quoted Bookmakers, make public announcements of LBO closures.

2.50 Commenting at an industry level, it is probably the case that the greatest effect in job losses will be felt at the 'junior level' (stable staff, jockeys, LBO staff etc.) and it may be that the HBLB could give consideration to the merits of re-directing Levy to support the weakest participants.

Levy scenarios – Appendix E

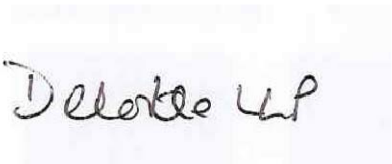
2.51 Based on estimates of the final yield from 48th Levy scheme, and discussions with the HBLB on likely Levy yield trends, we have developed 13 scenarios to provide illustrations of what the yield of the 50th Levy could be. They are not intended to be estimates of the likely yield:

Levy Scenario	Levy percentage rate	Levy threshold	Estimated 'middle range' of case scenario - 50th Levy Scheme yield
Basic forecast with thresholds	10%	£123,000	£60m
Basic forecast with no thresholds	10%	£nil	£77m
Inclusion of foreign racing with thresholds	10%	£123,000	£71m
Inclusion of foreign racing with thresholds	10%	£nil	£91m
Adjusting rates to yield £60m (Basic forecast) with the inclusion of foreign racing	9%	£123,000	£62m
Adjusting rates to capture amounts not captured offshore	11%	£123,000	£66m
Adjusting thresholds for changes in gross win with no allowance for media costs	10%	£51,100 (RPI) £49,000 (CPI)	£75m £75m
Adjusting thresholds for changes in gross win with allowance for media costs	10%	£66,500 (RPI) £64,400 (CPI)	£73m £73m
Adjusting rates to achieve yield of £130m	22%	£123,000	£129m
Adjusting rates to achieve yield of £130m with no thresholds	17%	£nil	£129m
Applying thresholds on a company basis	10%	£123,000	£76m
Applying thresholds on an aggregated basis	10%	£123,000	£56m
Rollover of the 49th Levy Scheme	10%	£93,000	£67m

Other observations – Appendix F

2.52 Our findings point to five other issues that the GAMs may wish to consider further:

- Distribution of the Levy between prize money and integrity and regulation;
- Holistic fixture economic review;
- Future of media rights;
- Leakage; and
- Focus of prize money.



Deloitte LLP

19 October 2010

APPENDIX A

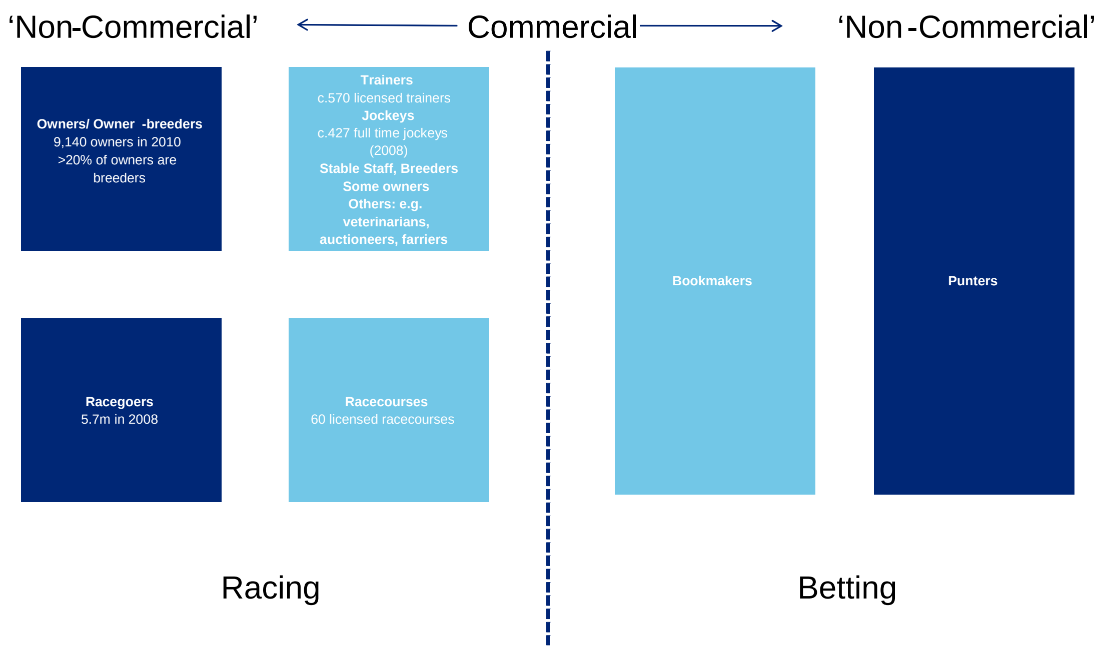
OVERVIEW

A.1 BACKGROUND AND CONTEXT

A.1.1 The key stakeholders in relation to the Levy can be broadly classified as Betting (which pays the Levy) and Racing (which receives it). However, the constituent parts of each of these groups are not homogenous in terms of the commercial / non-commercial motivations, size, scale, activities or interest in the outcome of the Levy.

A.1.2 Figure A1.1 below sets out the four broad categories of stakeholders[25] in Betting and Racing.

Figure A1.1



A.1.3 Those groups whose motivation we have described as commercial are those who make all or the majority of their income from their involvement in Racing or Bookmaking.

[25] All numbers are as of 2008 except for owners/owner-breeders for which we have 2010 data (as indicated).

A.1.4 Those groups we have classified as non-commercially motivated[26] are those who, in broad terms, spend more on their involvement in Racing or Bookmaking than they receive back by way of financial returns.

A.1.5 These are very broad classifications and there will be many exceptions in both categories. In particular, while as a matter of fact the majority of participants we have classified as non-commercial do not receive financial returns that would justify their investments, this does not mean that they are not interested in those returns.

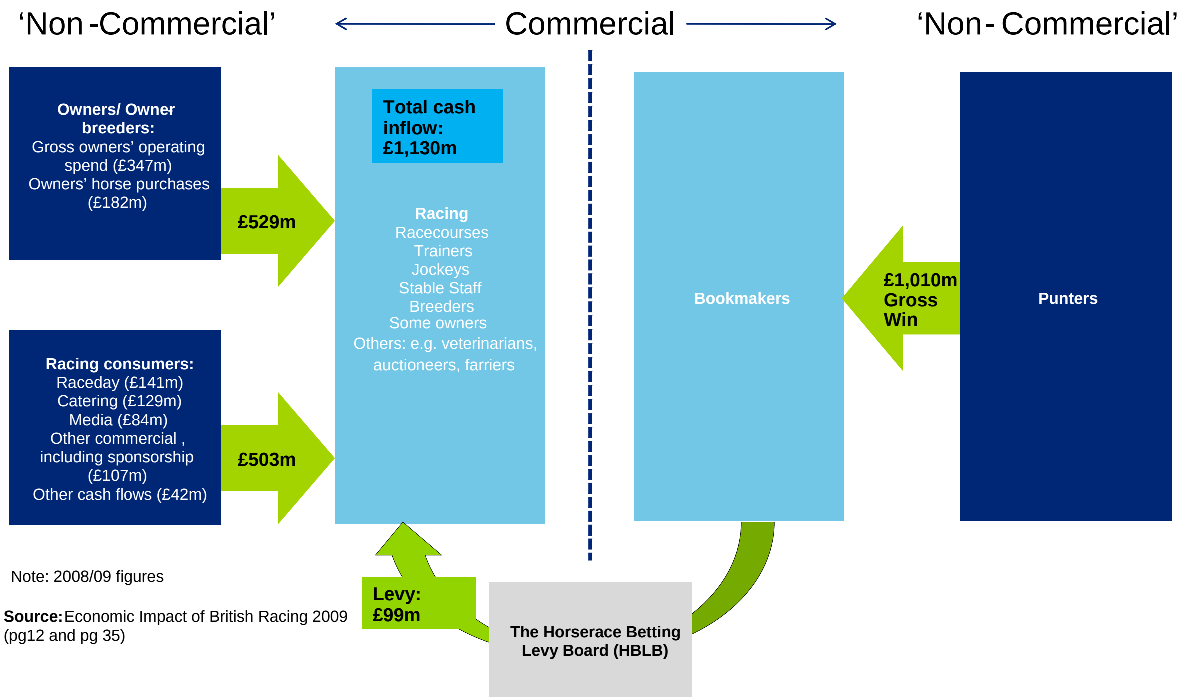
A.1.6 The reason for making this distinction is to illustrate the difficulty the GAMs face in deciding on the appropriate terms for the 50th Levy when, as we show below, the majority of funding for both Racing and Bookmaking comes from individuals who are not primarily commercially motivated.

A.2 CASH FLOWS

A.2.1 Figure 3.1 below summarises the cash flows into Racing from the various stakeholders. In 2008, the Levy represented around 9% of total cash flows into Racing being £99m of £1,130m[27].

[26] By this we mean not that the individuals are not interested in the financial returns, but rather that if their investment in Racing or Bookmaking were evaluated rationally it would show that for the vast majority of them they receive back less than they spend.
[27] Economic Impact of British Racing, 2009, page 12.

Figure A3.1



A.3 WHAT IS THE LEVY?

A.3.1 The Bookmakers and Racing have different views on the purpose and definition of the Levy.

A.3.2 Racing has provided comments setting out its views on what the Levy is (and what is not):

- The Levy is a grant and not a payment for content or a service. Racing argues that *'Levy expenditure is not a payment for content or a service. Levy expenditure is a grant to serve the objectives of the same as set out in the Act* [sic]*"; '*[28]

- It is not a 'subsidy' and is not a 'payment for a product'[29];

- The Levy is a yield. Racing uses the a quotation from the 41st Scheme determination by the Secretary of State (Tessa Jowell) to argue that the Levy is a yield that is based on the 41st Levy determination: ... the 41st

[28] Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, page 6.
[29] Racing interview.

Scheme "*could yield a figure in the region of £90m to £105m...*"[30]. Racing's interpretation of this quotation is "*having conducted an investigation based around the needs and capacity to pay, the Secretary of State considered it reasonable that the 2002/03 Levy amount would be in that range. This provides a basis which is, by definition, reasonable*";[31]

- Racing views[32] the Levy as a 'licence' to use the 'luxury brand' of British horseracing, albeit it is a brand without any of the normal brand protection mechanisms such as patents or trademarks;

- The Levy represents a value transfer[33] which takes into account all that Racing represents to Bookmakers. Racing argues that the industry expects a fair share[34] from anyone who benefits from the industry; and

- Racing notes that the Levy contribution from betting to British horseracing is considerably lower than such contributions in many other countries. For example, in France, the pari-mutuel PMU delivered €743m[35] (c. £621m[36]) in 2008 versus £99m[37] Levy in Britain[38].

---

30 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 19

31 Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 19-20,

32 Racing interview. Racing emphasised that Racing is selling a luxury good to owners and trying to provide owners with a return on the 'luxury good' by maintaining the brand. Racing representatives also pointed out that LBOs pay for media rights for British horseracing due to the strategic importance of British horseracing to Betting. From these comments, we infer that Racing sees the Levy as a 'licence' to use the 'brand' of British horseracing.

33 Racing interview.

34 Racing interview.

35 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 45

36 This conversion is based on the exchange rate on 15/09/2009 using the Financial Times online rate of €1.1958 to £1.

37 Note €743m includes all payments from Betting to Racing whereas £99m does not include, for example, media and sponsorship payments from Betting to Racing.

38 That this has been the position for many years is shown by the comments from Mr. Farr in his response to the December 1960 Order for the second reading of the Betting Levy Bill in the House of Commons. "*The real reason why racing conditions in the United States and France are superior in many ways to those in this country is that all betting there is channelled through the Tote- there are no bookies- and the Tote takes a fair proportion of the money laid in bets to support the racing industry.*"

A.3.3 The Bookmakers' views on what the Levy is and is not can be summarised as:

- It is compensation for loss of attendance at racecourses;[39]
- It is not a subsidy but a transfer to help Racing help itself;[40]
- It is not a price for a product;[41]
- It is a mechanism and not a yield.[42]

A.3.4 Further guidance on the original purpose of the Levy is provided by the Peppiatt Report produced in April 1960 by the Committee[43] appointed to examine the possible introduction of the levy system, identifies four key reasons for the Levy:

- *"Breeders were under financial burden which was resulting in overseas buyers purchasing too many of the best horses to the detriment of British bloodstock;*
- *Racehorse owners were contending with costs that were out of proportion with the amount of prize money available;*

---

[39] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 3.1, "*The Horserace Betting Levy was established under the Horserace Betting Levy Act, 1961 following the legalisation of off-course cash betting. The intention at the time was that the levy would compensate racing for an anticipated loss of attendance at racecourses following the introduction of high street licensed betting offices."*

[40] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 3.2, "*During the passage of the Levy Act, the Home Secretary, Mr R A Butler, emphasised that the levy was not intended to subsidise individual racehorse owners through the transfer of the public's money from one section of the community (punters) to another (owners). The point of the levy, Mr Butler said, was not to benefit any sectional interest, but to enable a great national sport and a great national industry to help itself.*"

[41] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 3.5, "*Home Secretary Mr Kenneth Baker in March 1992 when, in his determination of the 31st Levy Scheme (1992/3)" stated "The levy was never intended to provide a price for a product. Indeed, it is difficult to see how it could do so*."

[42] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 3.5, "*The language of the statute instituting the levy sets out the mechanism by which a levy is to be devised and created. It does not refer to a certain sum being paid from bookmaking to racing, and from the start recognises the fluctuating fortunes of competitive markets by reference to the fact that it needs to reflect the capacity of bookmakers to pay.*"

[43] On 9th November 1959, the Departmental Committee on a Levy on Betting on Horse Races (the 'Peppiatt Committee') was appointed by the Government to look into the possibility of a levy on betting on horse races.*'*

- *As a result of economic difficulties of horseracing, the fees of trainers and the wages of their employees were unduly low; and*

- *Racecourse owners were under considerable economic pressure and could not afford many of the improved amenities which were recognised as being desirable.*[44]*"*

A.4 THE PROBLEM FOR THE 50TH LEVY – WHAT NEEDS TO BE MEASURED?

A.4.1 There is a wide gap between the Bookmakers' Committee's proposal for a Levy which will produce an expected yield of £56-64m[45] and Racing's assessment that £130-150m is required to meet its reasonable needs.

A.4.2 Racing's assessment is based on its estimate of the 'reasonable needs of Racing' and the Bookmakers' on their 'capacity to pay.'

A.4.3 The derivation of these terms come from the following assurance from Mr Morgan, the Under-Secretary of State for the Home Department, made on 28 January 1969 during the reading of the Bill for the Horserace Betting Levy Act 1969 Act[46] *"If the Levy Board agrees with the Bookmakers' Committee's proposals the scheme is promulgated accordingly. If agreement cannot be reached the matter is referred to the chairman and independent members of the Board—that is, the three persons nominated by the Home Secretary—who may impose a scheme of their own. They are required, in doing this, to balance* ***the needs of horseracing against the capacity of the bookmakers to pay*** *(emphasis added), but having done that, their decision is absolute and there is no appeal against it."*

A.4.4 A letter from the HBLB to the Secretary of State on 30 April 2009 stated that the "*baseline for any Levy negotiation*" is "*any matter that is relevant in the circumstances at that time under the provisions of the 1963 Act... giving such weight to any matter(s) as appropriate, which may include the following:*

[44] Peppiatt Report dated 11 April 1960.
[45] See appendix E, paragraph E2.3
[46] Hansard 28 January 1969.

a) All prevailing economic, fiscal and social circumstances as may relate to Betting and Racing;

b) Betting's reasonable capacity to pay; and

c) Racing's reasonable needs."[47]

A.4.5 There is no statutory definition of the terms 'Racing's reasonable needs' or 'Bookmakers' capacity to pay'. Both are used as the basis for the 50th Levy submission and in previous submissions[48].

A.4.6 We assume that the impact of current economic, fiscal and social circumstances refers to both the impact on Racing (employees, owners, racecourses etc) and Bookmakers (small vs. large Bookmakers, impact on the punter).

A.4.7 We note that there is no guidance on the order in which the two tests should be applied. Is it:

- What are Racing's reasonable needs and then to what extent do the Bookmakers have the capacity to pay for those needs? or

- What is Bookmakers' capacity to pay and then can Racing demonstrate a reasonable need for payments of that amount?

A.4.8 This is a matter for the GAMs to determine albeit we note that Sir Philip Otton suggests the order should be to determine reasonable needs first, then capacity to pay.

---

[47] Letter from Robert Hughes (Chairman HBLB) to Gerry Sutcliffe Esq (Minister for Sport, Department for Culture, Media and Sport), dated 30th April 2009, page 3.

[48] For example the 41st and 47th Levy determinations - 41st Levy Scheme 2002/03, Memorandum to the Department for Culture, Media and Sport, November 2001, British Horseracing Board, page 13, sections 3: The Needs of Racing; Determination of the 47th Horserace Betting Levy Scheme, Submission of British Horseracing, 26th November 200, page 15, section 3.1: Racing Needs [sic].

APPENDIX B

RACING'S REASONABLE NEEDS

B.1 OVERVIEW OF THE RACING INDUSTRY – WHO IS RACING?

B.1.1 Racing is a relatively close knit community of owners, breeders, trainers, jockeys, stable staff, racecourse owners, administrators, regulators and supporting businesses.

B.1.2 Owners' total contribution to Racing's cash flow was £529m in 2008[49], which represented 46% of the total cash flow into Racing. This divided between gross operating spend of £347m and horse purchases of £182m. Owners each spent around £35,000 per horse in operating expenses (average for Jump and Flat horses) in 2008.[50]

B.1.3 There are currently 9,140 owners with horses in training. This number has dropped from its 2007 level of 9,550.[51] *The Economic Impact of British Racing, 2009* report records that there were 9,539 owners in 2008 and about "*.......40,000 individuals are estimated to have an involvement in horse ownership in some way*" through syndicates or racing clubs.[52] In 2008, around 80% of owners owned one or two horses and about 92 owners in April 2009 had 21 or more horses[53]

B.1.4 Owners in the UK make only a 23%[54] return from prize money as a proportion of their training costs compared to 100% in Hong Kong and 55%

---

[49] Economic Impact of British Racing, 2009, page 12.
[50] Economic Impact of British Racing, 2009, page 27.
[51] Impact on Racing of 2011 Levy Income forecasts at £68.8m, 2010 British Horseracing Authority, Annex (this number is based on a monthly average of owners with horses in training).
[52] Economic Impact of British Racing, 2009, page 27.
[53] Economic Impact of British Racing, 2009, page 27.
[54] 50th Horserace Betting Levy Scheme, Submission of British Horseracing March 2010, page 48.

in France[55]. Prize money in the UK fell from £116m in 2004 to £111m in 2009[56] in real terms.

B.1.5 Breeders invest significant time in developing bloodlines given the length of gestation periods and the time for horses to mature. In 2008, nearly 6,000 foals were produced by breeders from 10,740 active broodmares[57], the sixth highest volume in the world (based on 2007 comparatives). In 2009, there were 10,624 broodmares in Britain with 66% of them producing for Flat racing, 14% for Jump racing, 15% for dual and 5% for other[58]. About 55% of the broodmares based in Great Britain were born in the country, 27% were born in Ireland and around 10% in USA.[59] Breeders' operating expenditures were estimated at £202m in 2008.[60]

B.1.6 There has been a fall in demand for horses in the UK. Tattersalls reports that 64% of foals offered last year did not sell or sold for less than breeding costs[61]. The 2009 Weatherby's General Stud Book (Factbook 2009) shows that there was a shift from a permanent net import of 610 horses in 2006 to a permanent net export of 44 British bred horses in 2009[62]. It is not clear whether this fall in demand is cyclical as a result of the recession or the result of expanding international sales or a longer term structural issue.

B.1.7 There are currently around 570 licensed trainers in the UK and about 93% of those are represented by the National Trainers Federation ("NTF") [63] with around 15,600 horses in training (BHA estimates). Trainers are the 'sales

---

55 50th Horserace Betting Levy Scheme, Submission of British Horseracing March 2010, page 48

56 Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B. The prize money data is adjusted for inflation per note 6: '*All amounts are restated up to 2009 using December RPI for each relevant year.*'

57 Economic Impact of British Racing, 2009 page 32.

58 Weatherbys General Stud Book: Factbook 2009, Weatherbys GSB Ltd, page 8.

59 Weatherbys General Stud Book: Factbook 2009, Weatherbys GSB Ltd, page 11.

60 Economic Impact of British Racing, 2009 page 33.

61 The TBA Seminar: Discussing the business of breeding, Thoroughbred Owner and Breeder Incorporating Pacemaker, August 2010 (Issue 72), page 58. '*Lynam's statistics garnered from recent foal sales made for a gloomy opening. He estimated that at Tattersalls last year only 64% of the foals offered either didn't sell or sold for less than the cost of producing them...*'.

62 Weatherbys General Stud Book: Factbook 2009, Weatherbys GSB Ltd, pages 24-25. Permanent exports of British bred horses in 2006: 1,565; permanent imports into Great Britain in 2006: 2,175; permanent exports of British bred horses in 2009: 1,331; and permanent imports into Great Britain in 2009: 1,287.

63 Racing interview.

force' for Racing, promoting horse ownership to potential new owners and reinvestment by existing owners as well as training horses. Trainers are broadly dependent on prize money for profits and look to cover their expenses with the training fees they charge owners[64]. Trainers receive around 7-8.5%[65] of total prize money, depending on the quality of the race won.

B.1.8 The monthly average number of horses in training increased by around 9% between 2005 and 2010[66] and the number of fixtures run increased by 22% between 2002 and 2009[67]. Further reductions in prize money have taken place in 2010[68] and further substantial reductions have been agreed for 2011.

B.1.9 There were around 427 full time jockeys in 2008 with 121 holding professional licences for Flat racing and 99 for Jump racing. The remainder are apprentices or hold conditional licences.[69] Jockeys receive around 7% of prize money.[70]

B.1.10 Based on BHA estimates, in 2009 there were 4,814 full time stable staff and 2,230 part time stable staff[71].

B.1.11 There are 60 licensed racecourses in Britain which vary in size, type of racing, number of tracks and facilities. Some have All Weather Tracks, some include leisure facilities such as hotels and restaurants and others are overwhelmingly for raceday events only. The Jockey Club Racecourses,

---

64 Racing interview.
65 Racing interview.
66 Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B.
67 Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B.
68 Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B. The BHA estimate for 2010 prize money is £98.4m.
69 Economic Impact of British Racing, 2009 page 15.
70 Racing interview.
71 Extract provided by HBLB, Email from Richard Wayman, Assistant Racing Director, British Horseracing Authority to Douglas Erskine-Crum, Chief Executive, HBLB, Racing Statistics 2000-2009, Stable Staff.

Northern Racing Limited and Arena Leisure Plc own 32 of the racecourses and the remainder are independently owned[72].

B.1.12 In 2008, racecourses generated around £120m[73] in admission revenue[74]. The performance drivers for a racecourse are set out and summarised in Arena Leisure Plc's Annual Report and Accounts 2009 and presented in Table B1.1 below.[75]

Table B 1.1

Key business driver	Income stream	Activity
Fixtures and races	- Levy income - UK media rights - Other racing income	- Prize money - Integrity costs - Transmission to Licensed Betting Offices ("LBOs") in UK and Ireland - International media rights - Sponsorship - On-course betting commission - Racecards and advertising
Public and hospitality attendance	- Admission revenue - Catering income	- On the door sales - Advanced sales - Hospitality boxes - Season tickets - Food and beverage retail - Restaurants - Hospitality - Concessions
Non-racing activities	- Utilising racecourse facilities - Other leisure	- Conference and banqueting - Exhibitions and events - Hotels - Golf courses - Health club and spa

B.1.13 In the period 2002 to 2008 racecourses experienced strong attendances with crowds averaging 5.9m[76] per year[77] but this is expected to decline slightly. Racecourses expect lower demand for their events due to the recession.

[72] Economic Impact of British Racing, 2009 page 21.
[73] Note that Raceday income in Figure 3.1 £141m includes VAT at 17.5%.
[74] Economic Impact of British Racing, 2009, page 21.
[75] Annual Report and Accounts 2009, Arena Leisure Plc, page 15.
[76] Economic Impact of British Racing, 2009, page 24.
[77] Economic Impact of British Racing, 2009, page 24. 5.8m attendees in 2002, peaking at 6.1m in 2004 and falling to 5.7m in 2008.

Collective profits of racecourses in 2008[78] were £16.8m on a turnover of £456m[79].

B.1.14 Racecourses invested £556m in capital projects between 2004 and 2008[80] around 40% being at Ascot. The larger racecourse operators such as Arena Leisure Plc, Jockey Club Racecourses and Northern Racing have used capital investments to diversify their offer as 'leisure centres' such as hosting concerts, building hotels and conference centres,[81] although it has not been possible to do this at all their racecourses. Smaller racecourses are not necessarily able to diversify in this way or make large capital investments.

B.1.15 Racecourses are trying to appeal to the changing profile of racegoers by promoting events such as Ladies' Day and incorporating non-racing events on racedays (such as Friday / Saturday evening concerts / festivals)[82].

B.2 RECENT TRENDS IN RACING'S FUNDING

B.2.1 This section provides an overview of the recent trends in some of Racing's main income sources – corporate and private hospitality, media rights income, the Levy and other sources for prize money.

B.2.2 Several racecourses, such as Arena Leisure Plc are expecting a dip in revenues from corporate and private hospitality activities[83].

B.2.3 Corporate sponsorship contributions to prize money are expected to be limited in the 2010/2011 period. Although Racing offers large, popular fixtures and events for sponsorship, sponsorship could be limited due to the nature of the sport. Based on survey results in a 2008 BHA report, sponsors

---

[78] Racecourse Financial Performance, the Racecourse Association Limited, page 5.
[79] Economic Impact of British Racing, 2009 page 21.
[80] Economic Impact of British Racing, 2009, page 16.
[81] Racing interview.
[82] Racing interview.
[83] Arena Leisure Plc, Results for six months ended 30 June 2010, Arena Leisure Plc, page 3. *"Corporate and private hospitality revenues continue to be susceptible to the economic conditions, however, the period has seen a moderate improvement in hospitality attendances to 17,000 (2009: 15,000). We remain cautious about the outlook in terms of both attendance numbers and spend per head for this important revenue segment which (sic. remove 'which') remains some way off the peak levels of 2007 and 2008."*

found the *"sheer quantity of racing"* and the *"lack of differentiation between fixtures"*[84] a disincentive for sponsorship.

B.2.4 Racing has benefited from a rise in media rights payments. Media rights payments to racecourses have almost doubled since 2006 and the racecourses have signed contracts with Turf TV till 2018 and with SIS till 2016. Racecourses also receive revenues from picture rights sold to AtTheRaces (ATR) and Racing UK (RUK).[85] Media income is significant for many of the racecourses' financial performance[86].

B.2.5 The Levy is relatively small but critical to some aspects of Racing's funding (around 9% in 2008)[87] because it funds integrity and regulation costs and provides around 56%[88] of prize money. The chart below shows total prize money and the sources of prize money from 1980 to 2010[89].

---

[84] British Horseracing Authority, Strategic Review of the Fixture List, Findings Report, April 2008, Deloitte, page 6.

[85] Turf TV and SIS provide pictures principally to LBOs and ATR and RUK to subscription TV channels and the internet.

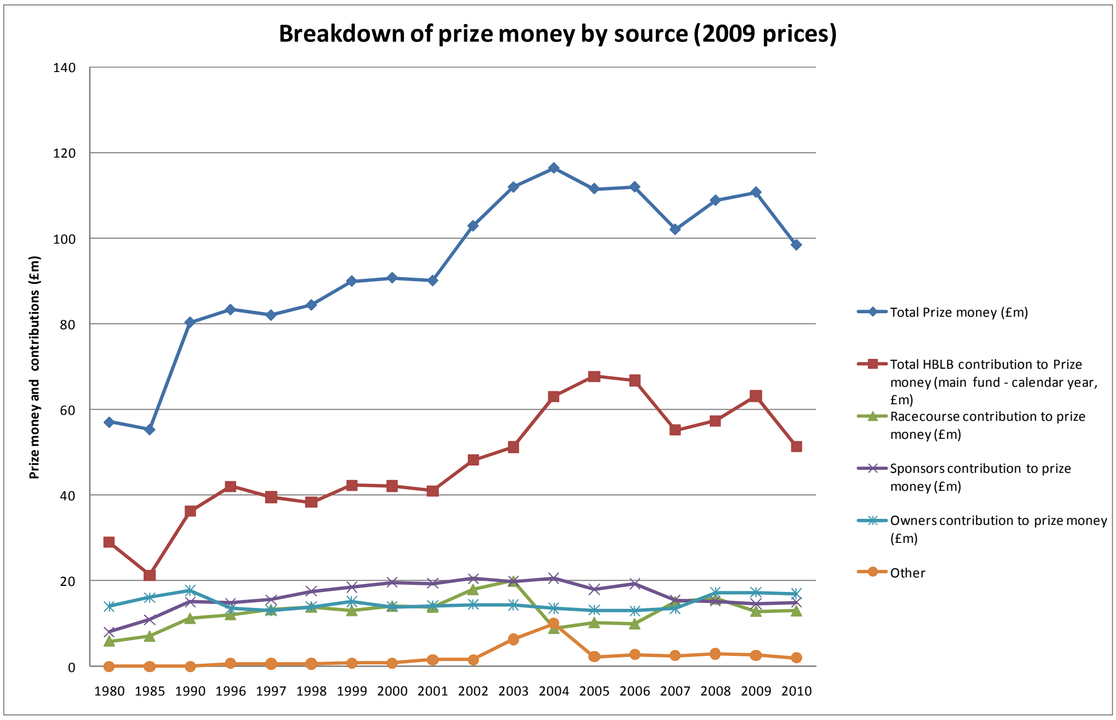
[86] For instance, Arena Leisure's 2010 Half Year Review quotes David Thorpe, Arena's Chairman: *"The expected increase in income from international media rights through ATR has also helped to deliver an increase in operating profit for the period, albeit from nine fewer fixtures."* Arena Leisure Plc, Results for six months ended 30 June 2010, Arena Leisure Plc, page 2.

[87] Economic Impact of British Racing, 2009, page 12.

[88] Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B. The prize money data is adjusted for inflation per note 6: '*All amounts are restated up to 2009 using December RPI for each relevant year.*'

[89] Impact on Racing of 2011 Levy income forecast at £68.8m, 2010, British Horseracing Authority, Appendix B. Note 7: *2010 figures are either to end May 2010, or full year estimates. The HBLB contribution to prize money is as per Table E of HBLB paper, i.e. Including £5.3m savings to prize money.* The source 'Other' includes: Divided Race fund and BHA scheme sources.

Figure B.2.1



Source: BHA statistics

B.2.6 Small racecourses are more dependent on the Levy and are taking measures to manage their costs. For example, Thirsk racecourse is capping its prize money contribution[90].

B.2.7 Based on the available evidence, it is likely that Racing will remain dependent on the Levy as a major source of prize money. However, there is scope for Racing to explore the extent to which other income sources (such as corporate hospitality and media revenues) can be expanded to help the industry manage employment and growth.

B.3 RACING'S REASONABLE NEEDS

B.3.1 There are two main issues to consider when addressing Racing's funding from the Levy:

- What are Racing's reasonable needs?

[90] Report and financial statements 31 March 2009, Thirsk Racecourse Limited, page 3. *'Where possible staff levels have been rationalised, the company's contribution towards Prize Money has been capped, and day-to-day expenses are constantly under review.'*

- To what extent should Racing's reasonable needs be funded by the Levy?

B.3.2 To determine the answers to these questions requires an understanding of Racing's costs and its sources of income.

B.3.3 We have provided an illustration of the proportion of costs and income which Racing has analysed in detail (see Figure B.3.1 below). The data used for this illustration is from different sources and time-frames. It does, however, demonstrate that Racing has not analysed in detail around 87% of its costs and 90% of its income.

B.3.4 The costs that need to be analysed include: veterinary research, trainers' costs, wages, owners' costs (other than transport), breeders' / horse costs and other commercial costs which totalled approximately £1,138m[91] in 2008.

B.3.5 The costs that Racing has analysed include: prize money (BHA estimate £98.4m 2010), integrity and regulation (£25m), owners' transportation costs for additional fixtures (£6.5m), fixture maintenance, additional fixture overheads and foregone raceday profits for additional fixtures and estimated raceday losses (excluding Levy distributions for additional fixtures), totalling approximately £150m.

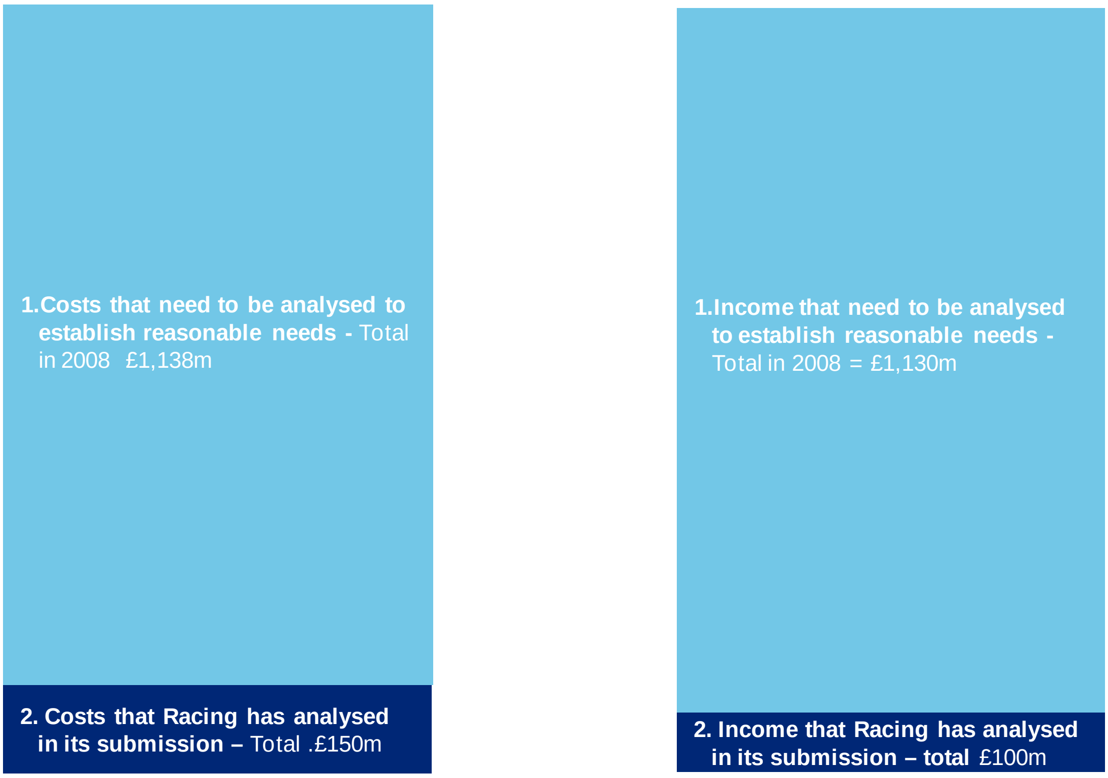
B.3.6 The income that Racing has not analysed includes: non-raceday income, media income, sponsorship and other cash flows (commercial financing etc) which totalled 2008 approximately £1,130m[92].

B.3.7 The only income that Racing has analysed in any detail is the Levy which was £99m in 2008[93].

B.3.8 Providing a more detailed analysis of revenue and costs would help build a much stronger case to establish and support a target yield.

[91] Economic Impact of British Racing, 2009, page 12.
[92] Economic Impact of British Racing, 2009, page 12.
[93] Economic Impact of British Racing, 2009, page 12.

Figure B.3.1



B.4 WHAT ARE RACING'S REASONABLE NEEDS?

B.4.1 There is no statutory, widely accepted or documented definition of 'reasonable needs,' or any clear definition in Racing's submission. Further Racing's and Bookmaking's views are different and cannot be reconciled.

B.4.2 Racing touches on the concept of what constitutes 'reasonable' and 'need' in its submission for the 50th Levy scheme. However, its discussion falls short of providing a specific, granular definition of 'reasonable need.' Racing also provides a brief insight on 'What should be considered when establishing a reasonable Levy yield to Racing?'[94]

B.4.3 First, Racing states that its 'view' that the Levy should deliver £130-150m was informed by the 'test' set out by the HBLB in its letter to the Secretary of State of 30 April 2009:

"The baseline for any Levy negotiation has always been... the following:

[94] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 11.

a) *All prevailing economic, fiscal and social circumstances as may relate to Betting and Racing;*

b) *Betting's reasonable capacity to pay; and*

c) *Racing's reasonable needs"'.*[95]

B.4.4 Second, Racing uses the statement by Mr. R. A. Butler[96] to reflect its views on the 'needs' of Racing: "*when considering the needs of Racing, it is not enough to consider what is required to prevent a "spiral of decline" in Racing – it is necessary to establish what is necessary to ensure the pre-eminence of the Racing industry, since this is the stated purpose of the Levy legislation... our pre-eminence in the breeding and racing of bloodstock should be maintained. I believe this [Act] will help to maintain it.*"' [97]

B.4.5 From the Bookmakers' perspective, the total contribution from Betting to Racing should be taken into account when assessing both capacity to pay and the needs of Racing. The Bookmakers' perspective on the 'needs of Racing' is discussed in more detail in Appendix C.

B.4.6 Previous consultants for the HBLB and industry experts also provide insights on the meaning of 'reasonable needs.'

B.4.7 The word 'need' has multiple definitions and nuances. Sir Philip Otton points out that "*the word 'need' has a variety of meanings from 'demand', 'necessity', to 'want' and 'wish.''*"[98] Based on our interviews with Bookmakers and Racing, Bookmakers perceive Racing's needs, as set out in their submission, to be an 'aspiration' whereas Racing argues its proposal includes 'necessities.' Sir Philip Otton also suggests *"that it would be*

---

[95] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 11.

[96] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 11. *'When introducing the Levy in 1961, the then Home Secretary (Mr R Butler)...,'.*

[97] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 11. *'When introducing the Levy in 1961, the then Home Secretary (Mr R Butler) (sic. Mr. R. A. Butler) stressed that "The justification for it is the need to provide the machinery by which a great national sport and a national industry can be prevented from getting into trouble or declining... our pre-eminence in the breeding and racing of bloodstock should be maintained. I believe this [Act] will help to maintain it."'.*

[98] Consultant's Advice to the Horserace Betting Levy Board, by Rt. Hon. Sir Philip Otton ('Otton I'). 13 October 2008, page 15, paragraph 38.

advisable to establish the precise and reasonable 'need' of Racing as the starting point of the exercise before considering capacity to pay."[99]

B.4.8 Sir Philip Otton makes a recommendation to Racing, saying it should create a business case to articulate 'Racing's needs.' This approach could help Racing to define and quantify its 'reasonable needs' and present a convincing, commercial argument. We agree with his view that Racing should present a business case to set out its arguments for the Levy scheme.[100]

B.4.9 The criteria to determine the 'needs of Racing' could include an assessment of Racing's 'return' to Bookmakers. For instance, in the 47th Levy determination Ministerial Statement, The Minister for Sport (Department for Culture, Media and Sport), Gerry Sutcliffe recognised that the needs of Racing had increased due to the expansion in the fixture list but was not convinced that this *"led to commensurate growth in betting on horseraces*."[101]

B.5 RACING'S THREE APPROACHES TO QUANTIFYING ITS 'REASONABLE NEEDS'

B.5.1 Although Racing does not provide a precise definition of its 'reasonable needs,' it does provide a list of 'costs' that the Levy should cover which could be interpreted as the 'reasonable needs' to be funded by the Levy.

B.5.2 In summary, Racing argues that the Levy paid should account for the following:

---

[99] Consultant's Advice to the Horserace Betting Levy Board, by Rt. Hon. Sir Philip Otton ('Otton I'). 13 October 2008, page 15, page 16, paragraph 40.

[100] Otton III Consultant's Advice to the Horserace Betting Levy Board (Final Version), by Rt. Hon. Sir Philip Otton, 19 December 2008, page 22, paragraph 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 also include a business case for the Levy Board's expenditure."*

[101] Written Ministerial statement for release on 20 February 2008: 47th Horserace Betting Levy Scheme (1st April 2008 to 31st March 2009), Department for Culture, Media and Sport, page 3. *'Third, I have borne in mind the British Horseracing Authority's claim that the needs of racing have grown, principally due to a sharp increase in the number of fixtures. However, I note that this increase has not resulted in any commensurate growth in betting on horseraces. I am therefore not persuaded that I should make any adjustment in the level of the Levy on the basis of the increase in fixtures.'*

- Racing should be given its 'fair share'[102] of Bookmakers' gross win. Racing note that Bookmakers made consistent levels of gross wins from British horseracing from 2002/03 to 2008/09 while the Bookmakers' contribution to Racing has declined from 19% to 15%[103] of the total financial contribution by all parties to Racing. Hence Racing argues it is not receiving its 'fair share' from Bookmakers[104]. Racing's arguments implicitly assume that the 50th Levy yield should correct this recent trend;

- British horseracing is the anchor product which draws customers into LBOs and hence the Levy paid should reflect the 'strategic importance'[105] of Racing to Betting;

- The additional fixtures staged by Racing since 2002 provide direct benefits to Bookmakers, and hence the Levy should cover compensation for the additional overheads and losses on BHA leasehold fixtures and partially cover owners' transportation costs;

- Bookmakers directly benefit from high quality of integrity practices consequently the Levy should cover all integrity and regulation costs; and

- Racing will face the risk of a 'spiral of decline' with further cuts in prize money which would adversely impact Bookmakers' gross wins. Hence, the Levy yield should aim to maintain prize money at least at current levels.

B.5.3 Bookmakers perceive Racing to be non-commercially motivated and argue that the Levy should fund Racing's needs to the extent that:

- The Levy yield is only based on British horseracing;
- Racing's activities are conducted as efficiently as possible to minimise costs; and
- Racing designs fixtures from which Bookmakers can benefit.

---

[102] Racing interview.
[103] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 15.
[104] This argument seems to be predicated on the assumption that Bookmakers' contributions to Racing should be increasing at the same rate as other contributions.
[105] Racing interview.

B.5.4 Racing uses three methods to calculate a range for a Levy yield. We outline the approaches and set out our comments on the assumptions adopted, the methodologies used and the evidence provided.

B.5.5 Table B.5.1 below summarises the outcomes of each approach and the final yield presented by Racing:

Table B.5.1

Approach	50th Levy Reasonable Return
Racing's Needs	£133-152m
Reasonable Share of Benefits	£128-149m
Market	£121-151m (£154-184m including convoyed sales)
Racing's Final Reasonable Levy Yield	**£130-150m**

Source: 50th Horserace Betting Levy Scheme, Submission of British Horseracing[106]

The 'Racing's Needs' Approach

B.5.6 The Racing's Needs approach is predicated on the assumption that the Levy should be based on the value of the 41st Levy and adjusted to cover the increases in Racing's costs i.e. inflationary impacts, increases in integrity requirements, the losses and additional costs associated with the BHA leasehold fixtures and part of owners' transportation costs.

B.5.7 Racing interprets the statement[107] by Tessa Jowell, the Secretary of State who determined the 41st Levy, to mean that the Secretary of State *'considered it reasonable that the 2002/03 Levy amount would be in that range [added, of £90-105m]...'*[108] Racing has *'therefore updated the 2002 determination to take proper account of how the needs of Racing and the other relevant circumstances, have changed since that time.'*[109]

---

[106] 50th Horserace Betting Levy Scheme , Submission of British Horseracing, March 2010, page 3.
[107] 50th Horserace Betting Levy Scheme , Submission of British Horseracing, March 2010, page 19. *'When announcing her decision the Secretary of State stated that the 41st Levy Scheme "could yield a figure in the region of £90m to £105m," and went on to say "this scheme should enable both the betting and racing industries as well as punters themselves to share in the benefits from the new tax regime"'.*
[108] 50th Horserace Betting Levy Scheme , Submission of British Horseracing, March 2010, page 19.
[109] 50th Horserace Betting Levy Scheme , Submission of British Horseracing, March 2010, page 20.

B.5.8 The key assumptions for each of Racing's 'needs' and the items covered in this method are:

- A 'base' amount of £74-89m[110]:
  - This 'base' amount is calculated by taking the extract from the Secretary of State's statement in the 41st Levy as establishing a principle that the Levy should produce a target yield of £90-105m;
  - The calculation is made by applying RPI to the 41st Levy amounts (excluding integrity and regulation); and
  - This amount reflects the *'inflationary aspects'*[111] of Racing's needs including the cost of funding capital investments, *'transport, equine feeding, utilities etc.'*[112]
- £25m of integrity and regulation costs which takes into account:
  - A more complex betting environment and changes in regulations since 2002;
  - Operational existing efficiencies that Racing has already introduced;
  - The expansion of the fixture list since 2002; and
  - The direct benefit of integrity to the Betting industry[113]
- £5.5m for 249 BHA Leasehold fixtures to cover:

---

110 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 27 being the "*2002/03 target yield*" of £90m to £105m "*less 2002/03 integrity costs*" of £16.2m resulting in a "*2002/03 target yield excluding integrity*" of £73.8m to £88.8m.

111 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28. *'The cumulative RPI inflation rate over 2002/03-2009/10 is 25%... In practice, many of Racing's costs – including transport, equine feeding costs, utilities etc- have experienced greater inflation than the 25%... we have excluded regulatory and integrity costs from this general inflationary uplift as there are very specific circumstances for these costs that require separate consideration... and hence have deducted the £16.2m integrity costs in 2002 from the original £90-105m range.'*

112 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28.

113 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, pages 28-29. *'Since 2002 regulatory and integrity efforts have been forced to respond to:*
- *a significant new challenge in monitoring betting activities...; and*
- *expansion of the fixture list...*

...Operational efficiencies in integrity provision have been introduced by the industry...'

- Raceday losses from the leasehold fixtures which were added to satisfy the demand from Bookmakers;

- Additional overheads associated with these additional fixtures; and

- A ‘reasonable’ return of £5,000 for each fixture[114]

Assessment: 41st Levy as the base for ‘Racing Needs’

B.5.9 Hansard records the Secretary of State as saying, “.....*I am therefore minded to determine the 41st scheme on the basis of off-course bookmakers paying an average of 9 per cent. of their gross profits on horserace betting*...” and continuing “...*it is hard to forecast how much the 41st Levy Scheme, determined in this way, will yield; but, on the basis of the forecasts previously provided by the betting industry, it would be in the range from £90 million to £105 million in 2002-03. A lower yield would reflect a lower level of profits.”.*[115]

B.5.10 The fuller extract of the Secretary of State’s statement indicates that if the scheme as set out was applied to the Bookmakers’ forecasts then the scheme would yield a Levy in the range £90m to £105m. It is not clear from this fuller extract that the Secretary of State was suggesting that the indicated range was a target for the Levy[116]. Further, the actual yield would depend on the Bookmakers’ actual profits and in the event the 41st Levy generated only £79.9m.

B.5.11 We note that each Levy is set by reference to the circumstances relevant at that time and there is no doctrine of precedent which requires the practices of previous Levy schemes to be adopted.

---

114 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, pages 30-32.

115 Bookmakers’ Committee response to the submission of British Horseracing in respect of the 50th Annual Horserace Betting Levy Scheme, 2010, page 13, paragraph 3.19.

116 The press release dated 29 January 2002 (http://www.gov-news.org / gov / uk / news / tessa_jowell_annouces_levy_scheme_determination/90932.html) states “*TESSA JOWELL ANNOUNCES LEVY SCHEME DETERMINATION - Culture Secretary, Tessa Jowell today announced her plans for the levy scheme which will run from 1 April 2002 to March 31 2003. The proposed scheme will be based on a payment by off-course bookmakers of around 9% of their gross profits from horseracing. It is expected that a scheme determined in this manner could yield a figure in the region of £90m to £105m for the Levy Board.*”

B.5.12 Moreover, the circumstances surrounding the 41st Levy determination makes it a weak base for the 50th Levy. The 41st Levy negotiations were 'clouded' by negotiations over a commercial deal on data rights and it was expected to be abolished in 2002. Hence it may not be the most 'representative' Levy Scheme to use as a base. [117]

B.5.13 The 47th Scheme which also went to determination but did not include any statement about potential yield is not referred to by Racing. Even if Levy Schemes previously determined by the Minister should carry greater weight than those settled by agreement, it is certainly questionable as to whether there is any basis for giving greater weight to the 41st Levy determination than the 47th Levy. Indeed, given that the 47th Levy determination is the more recent, the reverse may be the case.

B.5.14 Racing has not adequately substantiated its argument for the use of the 25% cumulative Retail Price Index (RPI) increase applied. The Bookmakers' Committee argues that using RPI is not appropriate as it includes mortgage interest payments and suggests that the RPI but excluding mortgage interest payments (16.5%) or the Consumer Price Index (CPI, 12.1%), may be more appropriate. A recent article in the Financial Times points out that RPI has a bias towards more expensive products and CPI 'favours' less expensive products[118].

B.5.15 Racing argues that the RPI is the most appropriate inflationary measure to account for the *'broad nature of costs'* for the industry, for example, the capital investment of £706m[119] between 2004[120] and 2008. Racing also

---

[117] British Horseracing Board, 41st Levy Scheme 2002/03: Memorandum to the Department for Culture, Media and Sport, November 2001, page 8 paragraph 1.3. A.1.1. '*The circumstances which led to the breakdown of the negotiations have been fully explained to DCMS... BHB does however take the opportunity to re-emphasise that the Bookmakers' Committee was only prepared to negotiate a levy settlement which was conditional on an agreement relating to pictures and data'.*

[118] Measuring up with a tale of two indices, Chris Gales, Economic Editor, Financial Times, September 14, 2010 (http://www.ft.com/cms/s/0/c4564aea-c031-11df-b77d-00144feab49a.html). '*The RPI uses one of two "arithmetic" averaging techniques for different goods: one which gives the greatest weight to the most expensive product; another which gives the greatest weight to items that have risen most in price. The CPI, by contrast, uses a "geometric" mean, which gives less weight to expensive products and those that have risen most in price.*

In short, RPI has a bias towards clothing in Paul Smith outlets, while CPI favours Primark.'

[119] £556m per Economic Impact of British Racing, 2009, page 16 – see B1.15.

states that many of Racing's costs have '*experienced greater inflation than the 25% increase,'*[121] that Racing's costs are '*labour intensive'*[122] and that historically RPI has been used by HBLB for its work[123]. This may be the case but it may also be the case that other costs have risen by less than 25%. In any event, Racing has provided no detailed analysis on this point.

Assessment: Integrity costs

B.5.16 In order to inform the issues on integrity funding, we set out our understanding of the background to what constitutes integrity and who funds it.

B.5.17 The British Horseracing Board ("BHB") contracted the Jockey Club to 'provide regulatory services.'[124] In 2007, the Jockey Club's regulatory functions and the BHB merged to form the BHA. The *'whole purpose of the merger was to operate as one organisation,'*[125] that is, as a single regulatory and governance organisation.

B.5.18 Based on documentation provided by the HBLB, integrity costs were divided into fixture, 'HFL' and integrity fees.[126]

---

120 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28. '*The most appropriate inflation rate to apply for Racing is the Retail Price index given the broad nature of costs that racecourses and other Racing bodies incur. Racing has invested £706m in capital expenditure to improve facilities between 2004 and 2008 alone... In practice many of Racing's costs... have experienced greater than the 25%...*'.

121 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28

122 Racing's summary critique of the 'Bookmakers' Committee response to the submission of British Horseracing in respect of the 50th Annual Horserace Betting Levy Scheme' page 2, Inflation: *'Such is the labour intensive nature of horseracing, it is fully appropriate that mortgage costs (and rises therein) be taken into account and hence we use the Retail Price Index here as the appropriate measure of inflation. There are parallels here with the healthcare sector and other labour intensive industries.*
Historically, the Levy Board has used RPI measures in all of its work; not only internally in forecasting cost increases, but in the annual increases to LBO Thresholds and Minimum Guarantees.'

123 Racing's summary critique of the 'Bookmakers' Committee response to the submission of British Horseracing in respect of the 50th Annual Horserace Betting Levy Scheme' page 2, Inflation (see quote above).

124 Letter from Chris Brand, Director of Finance and Corporate Services, British Horseracing Authority, 25 March 2010, Regulatory Costs 2010, page 1.

125 Letter from Chris Brand, Director of Finance and Corporate Services, British Horseracing Authority, 25 March 2010, Regulatory Costs 2010, page 2.

126 Extracts provided by HBLB on integrity and regulatory costs, 19th July 2010, HBLB Regulatory Costs, History of the HBLB regulatory and integrity costs, paragraph 4.

B.5.19 Currently, the '*Levy Board funds the cost of racecourse camera patrol and photo finish services, plus approximately 95% of the Authority's regulatory spend...*' which '*includes the provision of raceday officials to each fixture, comprehensive programmes of Equine welfare and Doping control... plus a comprehensive head office function...*'[127]

B.5.20 The HBLB also pays for the BHA head office costs of regulation. Currently, these costs account for 18% (or £4.5m) of the total estimated integrity and regulation costs (£25.2m) for 2010.[128]

B.5.21 In 2010, Levy is expected to account for c.60% of the BHA's income with the remaining 40% coming from fees from Racing participants such as jockeys and owners[129]. Currently Levy funds are used for integrity and regulation while the BHA funds governance from its own resources. The BHA determines the split of its costs between integrity and regulation and the split between regulation and governance.

B.5.22 Racing in its submission assumes that the Levy will continue to fully fund integrity and regulation and does not consider other options for funding integrity and regulation costs such as racecourses. Further it does not provide an analysis of the rationale for splitting integrity and governance costs between the two functions. For example 64% of executive costs and 75% of legal and professional costs are allocated to regulation[130]. However there are no detailed explanations to explain these allocations.

B.5.23 Racing argues that integrity costs have increased primarily due to the increase in the number of fixtures and a *"new challenge in monitoring*

- *'"Fixture fees" – the costs of licensed officials, the security and veterinary field forces and other costs deemed necessary to ensure that the high standards of integrity (as required by the Rules of Racing) were met;*
- *"HFL" Fees – drug testing services which are provided by HFL, which was owned by the HBLB until January 2007; and*
- *"Integrity Fees" – the provision of camera patrol and photo finish services.'*

127 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 29

128 Extracts provided by HBLB on integrity and regulatory costs, Analysis of HBLB Grants to Integrity Costs on a Fiscal Year Basis.

129 Extracts provided by HBLB on integrity and regulatory costs, British Horseracing Authority, plan and budget 2010, Chairman's committee, page 18.

130 Letter from Chris Brand, Director of Finance and Corporate Services, British Horseracing Authority, 25 March 2010, Regulatory Costs 2010, page 3.

betting activities".[131] Racing attributes this increase partly to the growth of Betting Exchanges. Based on analysis provided by the HBLB of BHA integrity costs, drug testing costs have increased by around 54% between 2002 and 2010, fixture fees by 75% and overall integrity costs by 64% compared to the 21% increase in fixtures between 2002 and 2010.[132] Racing has provided limited explanation on this disproportionate increase[133]. Also, as pointed out by the Bookmakers' critique of Racing's needs[134], Racing has not explained in any detail why integrity costs have increased by more than the RPI[135].

B.5.24 Although Racing refers to improvements in operating efficiency in integrity, there is no supporting evidence or examples to demonstrate the type or scale of efficiencies achieved. Racing argues that the BHA has every incentive to be efficient with integrity spending as integrity and regulation funding and prize money funding from the Levy are tradeoffs and the BHA has to convince racecourses that integrity and regulation is being provided as efficiently as possible[136].

B.5.25 However, there is no evidence to show what efficiency gains Racing has achieved to date or an assessment of whether there is potential to gain more efficiencies if racecourses funded or partly funded integrity and regulation costs.

---

131 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28.

132 Extracts provided by HBLB on integrity and regulatory costs, Analysis of HBLB Grants to Integrity Costs on a Fiscal Year Basis.

133 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28-29. '*Since 2002 Racing regulatory and integrity efforts have been forced to respond to:*

- *a significant new challenge in monitoring betting activities and associated results of races, including the impact of the growth of betting exchanges; and*
- *expansion of the fixture list...*

...Spending across all the areas of expenditure above has increased from £16 million in 2002 to £25 million in 2009. The increase is markedly higher (£4.8m) than the cumulative RPI over the period. Many of the reasons for the increase are set out above. Two further notable increases arose due to a step change in the cost of pension provision for the Authority's regulatory staff... and the end of a long lease at Portman Square in 2004 which saw a rise in office costs in the move to a new location (151 Shaftsbury Avenue...)'

134 Bookmakers' Committee response to the submission of British Horseracing in respect of the 50th Annual Horserace Betting Levy Scheme, 2010, Bookmakers' Committee, page 20, paragraph 14.9.

135 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 28-29 (see relevant quote above).

136 Racing interview.

B.5.26 Racing also highlights the risks of reducing integrity funding i.e. cutting integrity would adversely impact Racing's *'long term reputation as a betting product.'*[137] Racing also emphasises that integrity spend is higher for lower quality races and cutting integrity spend could increase the risk of race-fixing[138]. While there is clearly a risk in cutting integrity activities, it is not clear either that the costs of providing the current level of service are optimised or that the current level of service is necessary to preserve the integrity of Racing.

Assessment: Fixture profitability and additional overheads

B.5.27 Racing argues that it increased the number of fixtures due to a demand from Bookmakers. The fixture list has expanded since 2002 for two main reasons. First, by 2003, the Bookmakers had identified their preferences for the timing of fixtures and Racing responded by filling some of these gaps. Second, Racing added over 100 winter evening fixtures in response to a further demand from Bookmakers after the 2005 Gambling Act permitted LBOs to stay open longer.[139] .

B.5.28 The 'Racing Needs' method assumes that Bookmakers directly benefit from the 249 BHA leasehold fixtures which were added to meet Bookmakers' demands and hence the Levy should cover the raceday losses and additional overheads for these fixtures. Racecourses are facing a '*challenging outlook'* due to the current economic climate with expectations of a slow recovery for the hospitality market and limited sponsorship opportunities.[140]

B.5.29 Racing provides data to demonstrate that these leasehold fixtures are held during *'unattractive'* time slots and hence receive lower average revenues (£13,000) from admission receipts than other fixtures do (£44,000)[141] and generate losses before Levy distributions[142]. We note, however, that these

---

[137] Impact on Racing of 2011 Levy income forecasts at £68.8m, page 13.
[138] Racing interview.
[139] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 22.
[140] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 24.
[141] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 31.
[142] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 30.

fixtures are run which suggests that the combination of racecourse revenues and levy mean that they are probably profitable overall for the racecourses.

B.5.30 The increase in the fixture list has also resulted in a rise in overheads and maintenance costs. Racing has provided the following breakdown[143] for the £4m for costs associated with the additional fixtures:

- Additional overheads: £10,000 per fixture, £2.49m for 249 fixtures;
- Foregone non-raceday profits: £2,000 per fixture, £200,000 for 100 fixtures; and
- Need for reasonable return per fixture: £5,000, £1.245m for 249 fixtures.

B.5.31 The total for 249 fixtures comes to £3.935m and Racing's request is rounded to £4m in the submission. The evidence for each of these amounts is limited. For example, Racing states that the £5,000 '*need for reasonable return*' is based on a *'conservative assumption regarding the necessary return required to stage a fixture based on discussions with racecourse representatives*.'[144] However, there is no detail on the responses from the consultations or explanation to show why £5,000 per fixture is reasonable and conservative.

B.5.32 Racing argues that the costs associated with the 249 Leasehold fixtures should be funded by the Levy because Bookmakers directly benefit from the gross wins from these fixtures. However, the extent of this benefit may be less substantial than anticipated. A Strategic Fixture Review carried out in 2008[145] showed (for data collected between 1 September and 31 December 2007), the evening fixtures had 55% less betting turnover than the average race.

B.5.33 Racing would need to expand its fixture review and consider fixtures holistically[146] to determine which fixtures benefit Bookmakers and hence

[143] 50th Horserace Betting Levy Scheme, response to Deloitte query on the breakdown for the £4m under section 3.3.7 of Racing's submission for the 50th Horserace Levy scheme, 3 September 2010.
[144] 50th Horserace Betting Levy Scheme, response to Deloitte query on the breakdown for the £4m under section 3.3.7 of Racing's submission for the 50th Horserace Levy scheme, 3 September 2010.
[145] BHA: Strategic Review of the fixture list 2008, Deloitte 2008, page 26.
[146] Taking account of total fixture costs and revenues, owner costs and levy generated.

support the assumptions behind Levy funding to subsidise leasehold fixture costs.

B.5.34 Racecourses are commercial entities with multiple sources of revenue and the Levy cannot necessarily be expected to make fixtures profitable and provide a return. Racecourses could either be expected to manage fixture losses or decide not to hold additional leasehold fixtures if they were not profitable. Racing could strengthen its argument by providing an analysis of whether alternative sources of racecourse income could cover these costs.

B.5.35 Racecourses made a combined profit of £16.8m[147] in 2008. Around 80% of their revenues are controllable[148] and consumer spending on Racing approximately doubled between 2002 and 2008[149]. Currently, racecourses are expecting a drop in revenues from corporate hospitality[150] and racecourses such as Thirsk are taking measures to review expenses and cap prize money[151]. Part of this fall in revenue is expected to be mitigated (for example, by Arena Leisure plc) by media rights income[152]. In fact, the total annual racecourse revenues from media rights has increased by about 46% between FY 2007/08 and FY 2009/10[153].

B.5.36 A number of racecourses undertook substantial capital investment programmes, often funded by borrowing, during the period 2004 to 2008.[154]

---

147 Racecourse Financial Performance, the Racecourse Association Limited (Schedule 1), 2008 data.

148 Economic Impact of British Racing, 2009, page 21. Figure 11 shows that total revenue was £456m and controllable revenue in 2008 was £367m – hence controllable income is c80% of total revenue.

149 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 15. In the table 'Financial contribution to British Racing, 2002, 2005 and 2008, Racing consumers' contribution was £197m in 2002 and £404m in 2008.

150 Arena Leisure Plc, Results for the six months ended June 20 2010, Arena Leisure Plc, 2010, page 3.*'Corporate and private hospitality revenues continue to be susceptible to the economic conditions, however, the period has seen a moderate improvement in hospitality attendances to 17,000 (2009: 15,000). We remain cautious about the outlook in terms of both attendance numbers and spend per head for this important revenue segment which (sic. remove 'which') remains some way off the peak levels of 2007 and 2008.'*

151 Thirsk Racecourse Limited, Report and Financial Statements, 31 March 2009, Thirsk Racecourses Limited page 3. *'Where possible, staff levels have been rationalised, the company's contribution towards Prize Money has been capped, and day-to-day expenses are constantly under review.'*

152 Arena Leisure Plc, Results for the six months ended June 20 2010, Arena Leisure Plc, 2010, page 2. *'The expected increase in income from international media rights through ATR has also helped to deliver an increase in the operating profit for the period, albeit from nine fewer fixtures.'*

153 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, page 13. Racing received £38.4m and in FY09/10 £56.1m of media rights revenues.

154 Economic Impact of British Racing, 2009, page 16.

Any assessment on their capacity to contribute more to prize money or integrity and regulation costs needs to include an assessment of their capacity to service that borrowing[155].

B.5.37 Based on the evidence available on recent trends on racecourse profitability and income, Racing could present a stronger case for funding leasehold fixtures through the Levy if it also addressed racecourses' capacity (or lack of capacity) to absorb fixture losses and additional costs from all its income sources taking account of all its costs.

Assessment: owners' transportation costs

B.5.38 Racing makes a case for the Levy to partially cover owners' transportation costs. The premise of this 'need' is that owners' transportation costs have increased due to the expansion in the fixture list. Without support this increase could act as a disincentive for owners to continue participating in Racing and thereby reduce Bookmakers' gross win.[156] In fact, owners are already at a disadvantage in the UK because the returns from prize money in the UK are the lowest (23%)[157] compared to all other 'current major competitors,' (such as France and the USA). This is a disincentive for owners to keep investing in the sport[158]. Hence, the Levy should help alleviate some of the cost pressure on owners.

B.5.39 Racing's estimate of the total 'need' is based on £300 per horse for c.22,000 horses. This results in a total of £6.6m and Racing included £6.5m against this 'need.'

B.5.40 Owners' total transportation costs per horse is around 8% of the total owners' operating costs[159]. The £300 would account for 1.7% of the

---

[155] Racing interview.
[156] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 32.
[157] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 46.
[158] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 32. *'it is now common for a placed horse in a race at a leasehold fixture ... to win insufficient prize money to cover transportation costs.'* These conditions are '*a poor incentive for owners to run their horses and ultimately acts as disincentive for owners to remain in the sport.'*
[159] Economic Impact of British Racing, 2009, page 28. Based on Figure 17, the total average owners' spend per horse, flat and jumps in 2008 was £18,501 and £16,717 respectively and transport and racing

owners' total operating costs per horse. If we were to consider the raceday running costs provided by the BHA, the £300 would only cover 4% of these costs[160]- total raceday running costs per race are £7,192 and transportation is £400 of this total.

B.5.41 Based on the available information, the £300 subsidy is not a material portion of owners' total average operating expense for horses or of raceday running costs.

The 'Reasonable Share of Benefits' approach

B.5.42 This approach uses the 41st Levy 'yield' of £90-105m, as stated in the Minister's statement in the 41st Levy Determination[161] as a baseline and applies:

- An 'adjustment for inflation' using 'accumulated RPI over the period 2002-2012' of 27%;'
- A 'pro-rata fixtures-increment' of 23.5% for fixture increases between 2002-09; and
- An adjustment to account for a '50% substitution' which is 'considered to be a very conservative' estimate'[162].

B.5.43 The total yield from this method is £128-149m. The 'substitution effect' refers to the "*situation whereby some punters, given a greater number of British races to bet on, will fund these bets from a combination of higher overall stakes but augmented by some reductions / transferred stakes from existing races.*"[163] This 'reduction / transfer' is assumed to be 50%.

B.5.44 The assumptions in this methodology are open to challenge. First, as observed by Bookmakers[164], the calculation of the additional costs for fixtures assumes that the marginal cost of adding another fixture is constant.

---

expenses were £1,581 and £1,385 respectively which is c.8% of the total cost. £300 would be c.1.7% of the total average operating expenditure.

160 Impact on Racing of 2011 Levy income forecasts at £68.8m pg 10. *Estimate of Raceday costs of running vs. prize money:* Total cost of all (seven) races is £50,344.

161 See point B.7.6.

162 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 34.

163 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 33.

164 Bookmakers' Committee response to the submission of British Horseracing in respect of the 50th Annual Horserace Betting Levy Scheme, page 22 paragraph 4.32.

However, we would expect that if the fixture expansion is efficiently managed, the average cost per fixture should fall. Racing has not provided any evidence to support the fixtures increment of 23.5%.

B.5.45 Second, Racing assumes that '*the Levy has provided an inadequate return for the product supplied by Racing since 2004/05*.' It is difficult to determine what an 'adequate' return is without a robust definition of Racing's 'reasonable needs' or Bookmakers' 'capacity to pay.'

B.5.46 Racing provides some evidence to support its 'share of benefits' approach. Its submission highlights that the Bookmakers' financial contribution to British Racing has been declining (15% of the total contribution in 2008 compared to 19% in 2002)[165] even though gross win from horse racing has been at a consistently high level between 2003/04 and 2008/09 (more than £1bn per year between 2003/04 and 2008/09).[166] Hence, Racing argues that it has not received an adequate return from Bookmakers[167].

B.5.47 Racing argues that Bookmakers' gross win between 2003 and 2009 has directly benefitted from the additional fixtures staged by the industry. Racing refers to the turnover figures from 2006 in the Strategic Review which show that '*on average the gross win earned from each of the 161 extra fixtures staged in 2006 (excluding twilight fixtures) which had been added since 2002 was on average only 8% lower than the industry average.*'[168] However, the 2008 Strategic Fixture Review also found that the for winter evening fixtures (commencing in September 2007) '*betting turnover for the average race at an evening fixture was approximately 55% of the average race and at its lowest on Saturday evenings.*'[169]

B.5.48 Racing points out that it "*continues to be accommodating the Betting industry's requests that fixtures are staged at times to maximise betting*

165 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 15.
166 Economic Impact of British Racing, 2009, page 35, Figure 25: British Betting Industry Gross Win by type.
167 This argument seems to be predicated on the assumption that Bookmakers' contributions to Racing should be increasing at the same rate as other contributions.
168 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 34.
169 Strategic Review of the Fixture List – Findings report, 2008, page 26, section 6.2.

revenues"[170] and hence should get a "*reasonable apportionment of the revenues arising from the additional fixtures...*"[171]

B.5.49 However, it appears that not all the additional fixtures make an equal contribution to Betting. Hence, it is arguable that not all the fixtures should be accounted for in the "*pro-rata fixtures increment*".

B.5.50 It is also not clear how a 'reasonable share' is defined. Racing would need to provide more granular evidence on Levy generation by fixture and define 'reasonable share' to support and strengthen its assumptions in this model. It is not clear why Betting should be required to match increases in contributions to Racing made by other participants.

B.5.51 Without a robust definition and agreement on a) the purpose of the Levy b) Racing's 'reasonable needs' and Bookmakers' 'capacity to pay' and c) what constitutes a 'fair share'[172] the value of the 'share of benefits' approach is limited.

B.5.52 Third, this method assumes a 50% substitution rate but there is no evidence or analysis to support this figure or to explain why it is conservative.

The Market approach

B.5.53 This method assumes that the Levy is the '*price that might be agreed in a market negotiation between Racing and the bookmaking industry for a 'right to access racing for betting purposes''*[173]. This method results in a yield of £121-151m.

B.5.54 This approach simulates a market negotiation between Racing and Bookmakers and presents the maximum and minimum 'offers' from Bookmakers and Racing based on their relative bargaining power for a Levy 'price'. To reach the final yield range of £121-151m, Racing assumes that

---

[170] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 34.
[171] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 33.
[172] We note that the heading above section 24 Betting, Gaming and Lotteries Act 1963 is "*Contributions for benefit of horse racing by bookmakers and Totalisator Board*" and the final wording at the end of Section 24 (1) states *"....monetary contributions from bookmakers and the Totalisator Board."* indicating only a level of contribution by Betting rather than necessarily a fair share.
[173] 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 36.

Racing would retain 25% of the difference between the minimum and maximum points. By including the impact of convoyed sales, the range would be £154-184m.

B.5.55 The report by LECG details the data and modelling used to reach the proposed yields[174].

B.5.56 A fundamental assumption of the LECG report is that the product to which Racing is providing access is the product that Bookmakers want to buy. Based on our interviews with Bookmaking, this is not necessarily the case. Bookmakers prefer large fields[175] and closely competitive racing whereas Racing is focused on promoting and maintaining high quality races[176].

B.5.57 The Bookmakers provide an analysis to illustrate that the 'market method' can produce a different set of results for the 'betting upper bound.' The Bookmakers' response to Racing includes London Economics' data and an analysis which results in:

- £150m for the 'betting upper bound' versus the LECG range of £150-165m;
- £104m for the 'betting upper bound' if the model factors in opportunity costs; and
- £87m for the upper bound if the data includes 2009 figures and factors in opportunity costs.

B.5.58 The 'opportunity cost' is defined by London Economics as the 'cost of capital' i.e. the *'cost of remuneration of the debt and equity'* for the capital expenditure incurred by Bookmakers for LBOs.[177]

[174] Setting the 50th Horserace Betting Levy – An Economic Analysis, 9 March 2010, LECG Ltd.
[175] Bookmakers interview.
[176] Impact on Racing of 2011 Levy income forecast at £68.8m, page 10. *'The promotion of quality racing for the health of the sport, to the "improvement of British Horseracing" is, in Racing's view, of critical significance.'*
[177] Bookmakers' Committee response to the submission of British Horseracing in respect of the 50th Annual Horserace Betting Levy Scheme, page 31 paragraph 5.11. '*To provide an appropriate quantity and quality of betting opportunities to its customers, bookmakers incur significant capital expenditure in relation to the purchase, upkeep and improvement of its LBOs. This capital expenditure is generally financed through a combination of debt and equity... The cost of remuneration of the debt and equity has to be taken into account in assessing the economic viability of a business...*'

B.5.59 We do not express any opinions on the London Economics' critique of Racing's approach or on LECG's response to that critique other than to note that an analysis of this sort is open to a wide range of interpretations.

B.5.60 Finally, the argument for including 'convoyed sales' can also be challenged. British gross win from horseracing in 2008, was £741m more than double the next biggest, greyhound racing at £336m. Racing argues that these figures demonstrate that British Horseracing is the clear preference for punters.[178] Racing believes that the market method would produce a result of a Levy yield of £154-184m if the *'full contribution of horseracing to betting.'*[179] is recognised. We do not consider there is any widely accepted or convincing evidence for (or against) the convoyed sales argument; that is, evidence to show that British horseracing is the anchor product[180] which is *'directly responsible for bookmakers' FOBT earnings.'*[181]

B.5.61 Sir Philip Otton's report concluded that 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)...*"[182] This report draws *'a distinction between 'from' and 'derived from''* and states that '*as relates to*'[183] was wider in concept and that the phrase encompasses betting activities which establish a relationship or link between them and horseracing.[184]' This is a matter for legal interpretation.

---

178 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 18.

179 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 42.

180 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 18. "*...typically the anchor product that attracts customers to the shops who will then often bet on other products including FOBTs...*"

181 50th Horserace Betting Levy Scheme, Submission of British Horseracing, March 2010, page 55. *"... bookmakers could earn no FOBT revenues from LBOs if there was no betting available, and as betting on Racing is the primary form of betting in LBOs, Racing is, therefore directly responsible for bookmakers' FOBT earnings."*

182 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, page 5, paragraph 16

183 Betting, Gaming and Lotteries Act 1963, 27 (2)(a). *'Any scheme shall include provision – (a) for securing that the levy shall be payable only by a bookmaker who carries on his own account a business which includes the effecting of betting transactions on horse races and only in respect of so much of the business of the bookmaker as relates to such betting transactions;'*

184 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, page 5, paragraph 16.

B.5.62 We have been provided with two survey extracts potentially relevant to convoyed sales. One is the TNS survey conducted in 2007[185] which is cited in Sir Philip Otton's first report[186] which concludes that British horseracing is the key driver of LBO traffic for 63% of users of FOBTs. We note that Racing does not refer to this research in its submission on the 50th Levy. There are issues with the TNS report which go to the weight that can be put on it:

- Customers exiting bookmakers' shops were interviewed face-to-face. This implies that only people who wanted to answer the questions participated[187]. Hence, the survey did not use a random sample which may have introduced a bias into the survey;

- The survey was based on a sample size of 605 interviews with no assessment on the statistical significance of the sample size; and

- Some of the questions such as '*British Horseracing being shown in the betting office has no impact on when I choose to play the machines....*'[188] implicitly assume there is a link between British Horseracing and playing on the machines and this might create a bias in the results.

B.5.63 The TNS survey does not provide compelling evidence to show that there is a link between the punters' betting on British horseracing and using FOBTs.

B.5.64 The second survey was used to produce a 'Venn diagram' also cited in Sir Philip Otton's final report[189]. This survey was conducted by SPA Market Research in 2008 through face to face interviews. The interviewees were asked how often they place a bet on a list of products including Horse racing,

---

185 British Horseracing Authority, Bookmakers research: Mapping of the impact of FOBTs, September 2007, TNS.

186 The Horserace Betting Levy Board, Otton III: Consultant's Advice to the Horserace Betting Levy Board (Final Version) by Rt. Hon. Sir Philip Otton, 13 October 2008, page 11, paragraph 25.

187 British Horseracing Authority, Bookmakers research: Mapping of the impact of FOBTs, September 2007, TNS, page 6.

188 Bookmakers research form, TNS survey 2007.

189 The Horserace Betting Levy Board, Otton III: Consultant's Advice to the Horserace Betting Levy Board (Final Version) by Rt. Hon. Sir Philip Otton, 13 October 2008, page 26. The diagram is titled: Limited crossover between horse and other betting.

gaming machines and other sports/ events. It is not clear how the results were analysed to form the conclusions presented in the Venn diagram which shows a 9% crossover between ‘Horses and gaming machines.’ The 9% cross over would mean that British horseracing is not the anchor product which draws customers into LBOs or which encourages punters to use FOBTs. This research did not, however, seek to identify the principal reasons for punters entering the LBO.

B.5.65 The existing evidence available to us on convoyed sales is not conclusive to demonstrate either the extent to which Betting on horse racing is linked to the use of FOBTs or whether horse racing is the anchor product for customers betting in LBOs.

B.5.66 We consider that the available evidence is inconclusive as to whether horseracing is the ‘anchor’ product for LBOs.

APPENDIX C

BOOKMAKERS' CAPACITY TO PAY AND THE MECHANICS OF THE LEVY

C.1 CAPACITY TO PAY LEVY

C.1.1 In our view there are two issues to consider when assessing a Bookmaker's capacity to pay the Levy:

- Overall capacity to pay; and
- The 'base' on which the Levy should be charged.

C.1.2 By overall capacity to pay we mean the general ability of the Bookmakers to afford to pay, that is, what the business can afford. By the 'base' we are addressing the mechanics of the Levy, that is, on what element of the Bookmakers' results should the agreed levy percentage rate be charged.

C.1.3 Both Racing and the Bookmakers' Committee in their various submissions and critiques of each other submissions have, to some extent at least, treated these two as a single issue, albeit both advance views as to which sources of Bookmakers' gross win should be subject to the Levy and whether certain categories of Bookmakers' operating costs should be considered when assessing capacity to pay. Our view is that the two issues can be considered separately.

C.2 BOOKMAKERS' CAPACITY TO PAY

C.2.1 Each stakeholder has a different opinion on the Bookmakers' capacity to pay.

Bookmakers

C.2.2 The Bookmakers' Committee has not addressed Bookmakers' absolute (or overall) capacity to pay. Rather it has indicated that Bookmakers' capacity to pay has been reduced[190] as a result of a decline in revenue from British horseracing, the increasing costs of providing TV pictures/media rights into LBOs, rising Gambling Commission fees and compliance costs, rising rent, rates and marketing costs and difficult prevailing economic conditions[191].

C.2.3 The Bookmakers' submission states that "*the levy should continue to be based on a percentage payment of bookmakers' gross profits on horseracing business conducted in Great Britain[192]*" that is there should be no change in the 'base' on which Levy should be charged from the 49th Scheme[193] under which the levy percentage rate is charged on the gross win on British horserace betting business only.

Racing

C.2.4 Racing's view is that the Bookmakers' capacity to pay has increased[194] and should be based on a wider range of Bookmakers' activities including UK and foreign horseracing plus FOBTs/gaming machines.

C.2.5 Racing's submission states on page 12 that "....*when considering the gambling operators' capacity to pay, it is necessary to consider the whole of the bookmakers' businesses. This requires an assessment of the wider revenues*

---

190 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee paragraphs 1.7 to 1.10, 4.26, 4.36, 4.37, 4.40.

191 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 1.8.3 – *"(a) reduced disposable income for the consumer and (b) a budget that included VAT of 20% from 4 January 2011......".*

192 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 7.1 of states "*For the purposes of the 50th Levy Scheme, this term shall mean the gross profit derived from horseracing betting business conducted on horseracing taking place in England, Scotland and Wales only.*".

193 The 49th Levy Scheme states "*The amount of levy payable by each Bookmaker shall be determined by reference to the category into which that Bookmaker falls and calculated as the aggregate of the Bookmaker's liability to the levy in respect of all Betting Activities he undertakes*." and at all times Betting Activities are defined as "*British Horserace Betting Business*".

194 The 50th Levy Scheme, Submission of British Horseracing, March 2010, Section C, page 3 "*Betting's Increased Capacity to Pay*

• The Betting industry has experienced a period of sustained and rapid growth driven by deregulation, product diversification and the introduction of gross profits tax. By illustration the pre tax and interest profits of the "Big 3" Betting operators (William Hill, Ladbrokes and Coral) increased from less than £250m to over £750m between 2001 and 2008.

• The recession has seen declines in profits in 2009, but profit levels are still markedly higher than in 2002, and the Betting industry's confidence in the medium term health of the market is seen in the continued investment they are making.

• British Racing remains by some margin the largest sport for British betting operators. Since 2003/04 the Betting industry's gross win from British Racing has consistently been over £1bn, reaching a high of £1.2bn in 2007/08."

from the bookmakers' entire operation (i.e. including revenues made from gaming machines (including those previously known as FOBTs)[195]*.*"

C.2.6 Further, Racing submits[196] that "*In our view, Levy on overseas horseracing should properly now be reintroduced for the Levy should 50th Scheme. There is nothing in the Levy legislation which limits the Levy to business that relates to British horseracing, we consider it to be Racing's legal entitlement to receive Levy in respect of so much of the business of a bookmaker as relates to all horse races.*"

Factors affecting capacity to pay – media costs

C.2.7 The Bookmakers Committee argue that the Bookmakers' total contribution to Racing should be taken into account when assessing their capacity to pay.[197]

C.2.8 The Bookmakers' Committee notes that "*It has been argued previously that TV rights are not a commercial step towards the replacement of the levy but just another cost of doing business; and that the levy remains a statutory payment running in parallel to whatever commercial arrangements may from time to time exist.*"[198] It continues "*The Committee believes this to be wrong*

---

195 The 50th Levy Scheme, Submission of British Horseracing, March 2010. Racing's submission includes a footnote at this point: "*It is important to note that this is a distinct issue from the consideration of what constitutes leviable income. Bookmakers' income is leviable "in respect of so much of the business of the bookmaker as relates to ... betting transactions [on horse races]". However, the consideration of "capacity to pay" is not limited by those words, and Lord Pannick has advised Racing that a broader investigation of income when considering capacity to pay is entirely reasonable.*
The Bookmakers' Committee asserts that: it would be "an error of law and also irrational for the amount of the Levy to be based in anyway on ... non-British racing or from other sports or gambling (such as FOBTs)". This is legally incorrect, and Racing strongly disagrees. On the contrary, Racing would submit that it would be irrational if the Secretary of State was barred from taking account of income from sources other than bets placed on horseracing when it considers the capacity of betting operators to pay the Levy. This would, for example, enable the betting industry to use racing product as a "loss leader" from which it derives no direct profit, yet increases profit from other activities such as FOBTs, without any obligation to pay the Levy.
Separately, please also note that the Bookmakers' Committee have previously, and wrongly, conflated the questions of "capacity to pay" and "what constitutes the pool of leviable income". The latter is defined, in section 27(2)(a) of the 1963 Act, by reference to parts of the bookmakers' business that "relate to" bets on horse racing. The concept of "capacity to pay" is not limited in this way. The issue of what constitutes leviable income in Section 5."

196 at page 49.

197 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.1. "*It is wrong to assume that the levy, TV rights and sponsorship should be treated as separate; although one is a statutory payment, another, the result of a commercial relationship and the third a "discretionary" spend, all come from the same source.*".

198 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.3.

when a majority of the cost of TV rights provides further direct funds to racing in addition to that which already exists through the levy. This was acknowledged by the Secretary of State in his comments on the determination of the 47th Levy Scheme."[199]

C.2.9 The Written Ministerial Statement for release on 20 February 2008 on the 47th Horserace Betting Levy Scheme states: "*Finally, turning to the issue of Turf TV, I accept that an argument can be put forward that bookmakers' subscriptions to the new service constitute a commercially-based flow of money to racing, albeit only from certain bookmakers to certain racecourses. I therefore accept that it may have a material effect both on bookmakers' ability to pay and on the needs of racing. However, it is apparent from the failure of the Bookmakers' Committee and the Levy Board to agree, and from the OCP report, that bookmakers and the racing industry hold widely divergent views on the status of Turf TV and the impact that it should have on the level of the Levy. In time its full economic impact on bookmakers, racecourses and on horse racing generally may become clearer. However, at this stage I consider that it would not be appropriate to take Turf TV into account in setting the level of the 47th Levy.*"

C.2.10 In its submission the Bookmakers' Committee notes that "*A bookmaker providing customers complete TV coverage incurs substantial costs in doing so. Although it is impossible to be definitive due to the commercial confidentiality of Turf TV and SIS contracts, cost per shop is approximately £23,000 inclusive of VAT. This will increase in January 2011*[200]." In response to enquiries from the GAMs, the Bookmakers' Committee provided a split of this estimate between the costs of Turf TV and SIS together with some analysis of the SIS figure which, on the basis of the descriptions provided, does include costs of the supply of services that are not related to British horseracing. The Bookmakers' Committee's submission on 15 October 2010[201] indicated that 90% of the costs of Turf TV and 65% of the costs of

---

199 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.4.
200 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.28.
201 Letter dated 15 October 2010 from Will Roseff to Paul Lee.

SIS related to British horseracing with a total cost per shop of £15,400 relating to British horseracing.

C.2.11 Racing argues that Levy payments, media rights and sponsorship should be treated separately[202] and also notes that media spend is to some extent discretionary.[203] On this last point, we understand[204] that most Bookmakers have contractual commitments to pay for media rights which extend beyond March 2012. Hence, for the purpose of assessing capacity to pay the 50th Levy, Bookmakers no longer have the discretion not to spend the amounts to which they are contractually committed.

C.2.12 The Bookmakers Committee note that the "*Inclusion of TV rights costs leads to a considerably larger contribution by bookmakers to horseracing, particularly over the last 2 years. British bookmakers, and in particular retail LBO operators, now pay more in levy, TV costs and sponsorship, than ever before. The amount of bookmakers' horseracing revenue spent in this way has reached 27.5%*[205]."

C.2.13 We note that there is a significant difference between the amounts paid by Bookmakers[206] and the amounts received by Racing[207].

C.2.14 Further we note that SIS is part owned by three Bookmakers (73% approximately) the Tote (6% approximately) and four racecourses (less than 1%) and Turf TV is 50% owned by a number of racecourses. Neither

---

[202] In its Initial Critique of the Bookmakers' Committee's Recommendation, page 10 and 11 that "*Levy payments, media rights and sponsorship rights are completely distinct markets. That the source is the same is irrelevant.*" Further at page 3 of the critique it notes that *".....it appears that the BC have incorrectly allocated all charges from SIS and Turf TV to the cost of British racing. Given that these charges are for the provision of a broad range of LBO services encompassing British racing, overseas racing, greyhound racing, virtual racing (horses and greyhounds), numbers games, lotteries and general sports betting opportunities etc, this is a clear overstatement*".

[203] In its Initial Critique of the Bookmakers' Committee's Recommendation, page 11"*One significant independent LBO operator, Chisholms, chooses not to buy the Turf TV service, a choice available to any LBO operator*."

[204] Bookmakers interview.

[205] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.31.

[206] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.29. "*The annual cost to the betting industry of providing TV coverage to LBOs is in the order of £200M.*"

[207] The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 4.6. *"£38.4M received by racing (racecourses) for media rights in FY07/08, £52.9M received by racing (racecourses) for media rights in FY08/09, A 38% increase year-on-year from FY07/08 to FY08/09, £56.1M received by racing (racecourses) for media rights in FY09/10*."

submission takes account of the revenue flows to some element of both Racing and Bookmaking that result from these ownership stakes.

Factors affecting capacity to pay – overheads

C.2.15 The Bookmakers' submission provides details of gross win on horseracing and overall gross win on all products[208] together with details of the relative market share of betting products[209]. However no details are provided of the other costs incurred by Bookmakers on each betting product so as to allow us to understand the actual trading performance of each betting product. In our view such an allocation of overheads would be difficult to formulate especially in relation to the major costs of LBOs rent and employment costs. As a consequence it is not possible to provide a meaningful analysis of the net profit earned by Bookmakers by product.

Factors affecting capacity to pay – trends in gross win

C.2.16 The Economic Impact of the British Betting Industry report[210] shows the recent trends in British horseracing betting and Bookmakers' overall gross win. We note that over the period 2002 to 2008 the Bookmakers' overall gross win has increased year on year (in 2009 there is a dip in both overall gross win and British horseracing gross win) albeit British horseracing gross win has remained essentially static over the period since 2003/04.

---

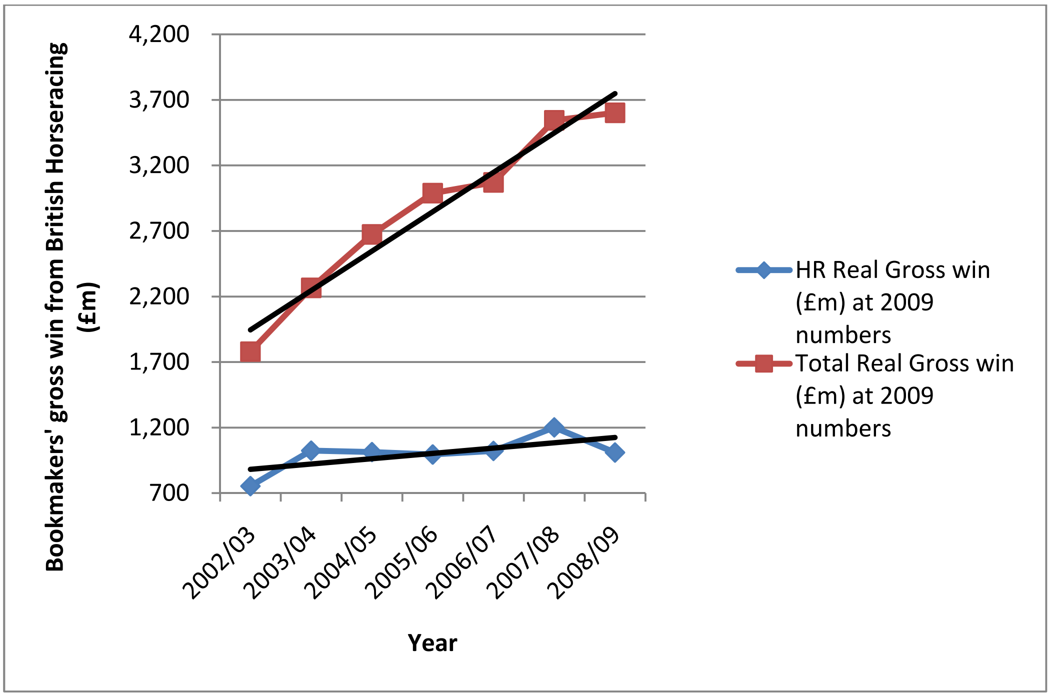
208 For a period of ten years (2000 to 2009) in The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, Figure 5, but only provided for a period of three years (2007 to 2009) in the 50th Horserace Betting Levy Scheme Report for the Bookmakers' Committee -Analysis Update, Ernst & Young, page 4, figure 4 received 15 October 2010.

209 For a period of ten years (2000 to 2009) in The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, Figure 6 but only provided for a period of three years (2007 to 2009) in the 50th Horserace Betting Levy Scheme Report for the Bookmakers' Committee -Analysis Update, Ernst & Young, page 3, figure 3 received 15 October 2010.

210 An Economic Impact of the British Betting Industry dated January 2010 page 38. Figures were also included in The 50th Levy Scheme – Recommendations by the Bookmakers' Committee (figures 5 & 6). However, when the figures were revised in the 50th Horserace Betting Levy Scheme Report for the Bookmakers' Committee -Analysis Update, Ernst & Young, received 15 October 2010 figures for years prior to 2007 were not adjusted. This means that the Bookmakers' Committee's submission does not provide this information prepared on a consistent basis.

C.2.17 The graph below sets out British horseracing ("HR") (blue line) and total gross win for betting operators (red line) for the period 2002/03 to 2008/09[211] and trend lines (black lines). All figures are presented in 2009 terms[212].

Figure C2.1



C.2.18 We do not have details on media costs historically. We understand that they have increased in recent years. If this is so, inclusion of media costs as a deduction from British horseracing gross win would tend to flatten the trend line above even further.

C.2.19 Although the gross win from British horseracing has remained broadly constant over the period it is the case that the Bookmakers' overall capacity to pay at a total gross win level has increased each year over the period with the exception of 2009.

C.2.20 The Bookmakers' Committee informed us[213] that while Bookmakers' gross win has increased over the period, net profit has remained static or even deteriorated. This is due to the increase in costs in developing and providing

---

[211] An Economic Impact of the British Betting Industry dated January 2010, page 38, .

[212] Adjusted from the data in An Economic Impact of the British Betting Industry dated January 2010, page 38, on the basis of relevant changes in CPI.

[213] Bookmaking interview.

the new betting products that have driven the growth in gross win. This effect can be seen in the continuing level of LBO closures.

C.2.21 We set out in the table below an illustration as to the very different capacities to pay depending on whether the measure of capacity to pay is limited to British horseracing only or is expanded to include overall LBO activity.

Figure C2.2

		British Horseracing		LBOs	
	Gross win	£640m	1	£2750m	2
	less Gambling Duty at 15%	£96m		£413m	3
		£544m		£2337m	
	less Media Rights	£131m	4	£195m	4
	Contribution to other costs	£413m		£2142m	
	Contribution per shop before Levy, staff costs and overheads	£48,600		£252,000	
1	Profit from British horserace betting based on LBO declaration figures provided by HBLB re 48th Levy Scheme.				
2	23.27% of 2009 gross win attributed to British horseracing - Ernst & Young via Bookmakers' Committee on 15 October 2010.				
3	We have assumed that the amusement machine licence duty ("AMLD") on FOBTs will equate to Gambling Duty at 15%.				
	As AMLD is charged per machine dependant upon cost per play and payout we cannot otherwise estimate its effect.				
4	We are advised average annual media cost is £23,000 per LBO. The Bookmakers' Committee's submission on 15 October				
	2010 indicated that media costs were £15,400 per LBO relating to British horseracing.				

C.2.22 These figures are intended only to be illustrative of the scale of capacity to pay and limited by comments 1 to 4 noted above and certain other limitations identified in discussion with HBLB including:

- the 2009 figures provided by Ernst &Young on 15 October 2010 indicate that British horserace betting was 23.27% of total Bookmakers' revenue across all platforms, including LBOs, telephone and internet, not just LBOs;

- within the LBO only market, HBLB believe that it is probable that British horseracing represents a higher proportion of the LBO's business;

- the 48th Levy Scheme default percentage[214] for British horseracing business was 43% which is derived from the actual gross win on British

[214] This is the percentage used by an LBO to calculate the value of its British horseracing gross win from its total LBO gross win where that LBO does not have EPOS data to provide the actual value of gross win relating to British horseracing business. It is based on the actual outturn from the 'Big 3' bookmakers.

horseracing business generated by LBOs expressed as a percentage of gross win generated by all products except machines, using this percentage would indicate a total LBO gross win of £1,490m excluding FOBTs; and

- we have assumed that all the LBOs purchase media from both Turf TV and SIS (when in fact a minority of firms only take one service e.g. Chisholms).

C.2.23 Notwithstanding the uncertainties and approximations, these figures do indicate a relative measure of capacity to pay and show LBOs' capacity to pay based on their total gross win is many times their capacity to pay on the basis of British horseracing gross win only.

C.2.24 As noted above, the Bookmakers' submission suggests that the Levy base should be limited to British horseracing only. However the Bookmakers' submission indicates that on a marginal contribution basis in 2009 "*The marginal contribution of British horseracing to the 'Big 3' retail estates, before paying the levy, would be £43.9M*", the "*....levy paid would be £45.6M*" and that "*This means that in those circumstances, the marginal loss suffered by the Big 3 retail estates, after payment of the levy, would be a loss of £1.7M*". This appears to indicate that on a marginal basis Bookmakers have close to zero capacity to pay based on British horseracing only.

Observations on capacity to pay

C.2.25 We have the following concluding observations in relation to Bookmakers' capacity to pay.

C.2.26 In our view the Bookmakers have not demonstrated an ***incapacity*** to pay. By this we mean that the Bookmakers have not demonstrated that they could not pay more than has been offered on the basis of their proposal for the 50th Levy Scheme that is the offer is not supported by evidence that it is all they can afford.

C.2.27 We consider that gross win is a better measure of capacity to pay than turnover albeit we would consider that net profit or cash flow would be better still.

However, as discussed above we recognise that it would be impractical to apply these measures to Bookmakers' businesses.

C.2.28 Whichever base is taken on which to calculate the Levy, we agree with the Ministerial Statement on the 47th Levy[215], that the cost of media rights is a factor that influences a Bookmaker's overall capacity to pay.

C.3 THE MECHANICS OF THE LEVY

Options to alter the mechanics of the Levy

C.3.1 In our Bookmaking and Racing interviews (as applicable) we discussed four options for altering the mechanics of the Levy Scheme and asked for the views of Bookmaking and Racing on these options:

- Turnover vs. Gross Win.
- Thresholds vs. Rates.
- Company vs. Shop Scheme.
- Foreign racing and other products.

Turnover vs. Gross Win

C.3.2 We proposed a scenario to both Racing and Bookmakers whereby a Levy percentage rate would be applied to either turnover or gross win calculated so that the resulting quantum of the Levy raised was the same and asked which basis was preferable.

C.3.3 Racing indicated that it would prefer a return to a Levy Scheme based on turnover (as was applied up to and including the 40th Levy Scheme)[216].

C.3.4 Racing expressed the view that it is better able to influence the level of betting turnover rather than gross win by reference to numbers of races it provides during the year and by the provision of an entertaining 'spectacle' or 'product'

[215] C 2.9.
[216] 50th Horserace Betting Levy Scheme, submission of British Horseracing, March 2010 page 49. '*It is our view that there is no proper place for a Thresholds system in any Scheme where LBO contributions are calculated by reference to gross profit...*'

of quality racing for spectators. Racing also points out that it takes the risk of staging fixtures but is dependent on a 'managed' Gross Profit number[217] for a return from the Levy. [218]

C.3.5 Racing considers that it cannot influence how successful Bookmakers are in generating a profit from the racing it provides, neither can it ensure that Bookmakers maximise their gross win at a meeting and noted for example that the Bookmakers' level of gross win at Royal Ascot 2010 was minimal despite the provision of quality racing.

C.3.6 It believes that a Levy based on turnover would be more 'predictable' in value and less subject to annual fluctuation, allowing Racing to plan better based on a more certain income stream[219]. It again cited the example of Royal Ascot 2010 which generated significant betting turnover for Bookmakers but did not generate significant gross win.

C.3.7 Racing is also concerned that Bookmakers use British horseracing as a loss leader to attract other types of betting for example by providing free bets thereby depressing the level of British horseracing gross win.

C.3.8 The Bookmakers indicated that their preference was to retain the existing gross win basis and argued that as commercial businesses they always seek to maximise their profits on any betting and thus seek to maximise gross win.

C.3.9 The Bookmakers maintain that Racing could influence the level of gross win at a meeting and for individual races by providing quality[220] horseracing that encouraged punters to bet. Bookmakers identified such races as having large

[217] Racing indicated that the gross win value on which levy would be paid was dependent upon the Bookmakers' strategy for managing their business. For example Bookmakers might offer a promotion on another betting product offering a free horseracing bet which would not create any horseracing gross win or offer a 2 for 1 football bet so discouraging betting spend on horseracing.
[218] Racing interview.
[219] Racing interview.
[220] We noted that the view of 'quality' racing as defined by Racing and Bookmakers differs significantly – a field of premier horses vs. large, close finishing fields.

fields of horses, close racing and blanket finishes[221] and would keep punters entertained throughout.

C.3.10 Finally Bookmakers believe that gross win is more closely aligned to their ability to pay than a turnover based levy would be.

C.3.11 Although each Levy Scheme is unique, we note that the Secretary of State for Culture, Media and Sport in making a statement about the determination of the 41st Horserace Betting Levy Scheme identified that turnover was not the most reliable basis to determine Bookmakers' capacity to pay and favoured gross profits (win)[222].

C.3.12 The report by the OCP Consultants to DCMS on the 41st Levy determination also stated that "*gross profits [sic. gross profit] provides a more certain method of ensuring that the Levy reflects bookmakers' ability to pay*."[223]

C.3.13 While a turnover based Levy might have the benefit for Racing of producing a less variable level of income we consider that gross win is more closely aligned with capacity to pay than turnover. A Levy based on turnover has a greater risk of being 'unaffordable' to some Bookmakers, although the existence of suitable thresholds may mitigate this risk.

Thresholds vs. Rates

C.3.14 We asked the Bookmakers' Committee why, when proposing the 50th Scheme, it had adjusted the threshold rather than seeking to achieve a similar effect on

221 Larger fields both increase the average the gross win per horse and the overall gross win on a race. Based on an average gross win of 1.5% gross per horse a 12 horse race would provide 18% gross win compared to a six horse race providing 9% gross win.

222 http://www.publications.parliament.uk/pa/cm200102/cmhansrd/vo020129/text/20129w13.htm - *The exercise of my responsibility to determine the 41st Scheme has been made difficult by uncertainties currently facing the betting and racing industries. These include the effect of the introduction of a gross profits tax on betting, and the potential income for racing from its proposed sale of picture and data rights to bookmakers. As to the former, it is difficult to judge the extent to which changes in bookmakers' turnover on horseracing betting will be reflected in their gross profits on that business. 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. In all the circumstances, I am therefore minded to determine the 41st scheme on the basis of off-course bookmakers paying an average of 9 per cent. of their gross profits on horseracing betting*."

223 Determining the 41st Levy Scheme: Final report by Organisation Consulting Partnership for the Department of Culture, Media and Sport, December 2001, section 4.3, Gross Profits, commentary for 'Arguments For'.

the Levy take by reducing the Levy percentage rate and maintaining the existing thresholds.

C.3.15 The Bookmakers (apart from the Tote) indicated that they favoured the maintenance or increase of thresholds so as to protect smaller / marginal LBOs, and, given the present economic conditions, favour an increase in thresholds over any reduction in Levy rate. The Tote favoured a reduction in the Levy rate to 9% and some lowering of thresholds.

C.3.16 Racing has based its submission on a required monetary value for the Levy yield and consequently does not express a view on the setting of thresholds and rates, albeit it would logically seek to minimise thresholds and set a rate necessary to achieve the overall Levy yield required to meet its needs. Racing has however expressed the view that thresholds for the smallest operators would be justified on the grounds that thresholds would help to increase consumer choice by ensuring smaller operators continue in business.[224]

C.3.17 We note that although the Bookmakers' Committee *"........recommend an above inflation rise in the LBO threshold to £123,000*[225]." it does not indicate why this exact level of threshold was chosen albeit we note the underlying rationale advanced by Bookmaking for an increase in the threshold[226]. We estimate, based on the detail contained in Annex A to "*The 50th Levy Scheme – Recommendations by the Bookmakers' Committee",* that such a threshold would result in approximately 90% of LBOs paying an abated levy percentage rate below 10%.

C.3.18 Further, we note that the HBLB is required by statute[227] to take account of different categories of Bookmakers[228] which the Bookmakers' Committee

[224] Racing interview.
[225] The covering letter to The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 7.
[226] Being increases in certain specified costs and the protection of smaller bookmakers.
[227] Betting, Gaming and Lotteries Act 1963, section 27(2) *"Any such scheme shall include provision.....(b) for bookmakers to be divided for the purposes of the levy into different categories;..."*
[228] The GAMs may wish to consider whether to categorise separately Bookmakers whose behaviour has invalidated the assumptions underlying the Bookmakers' Committee's prior year recommendations.

argues should be interpreted as necessitating relief for small Bookmakers[229] (albeit categories are not defined in the Act).

Company vs. Shop Scheme

C.3.19 We note that that Levy schemes prior to the 41st Levy offered Bookmakers an option to elect to be charged Levy based on either a shop or a company / corporate group basis and asked whether there would be benefits in reintroducing such an arrangement for the 50th Levy.

C.3.20 Bookmakers, both large and small, without exception consider the re-introduction of such an option as inequitable.

C.3.21 Racing considers this to be a matter for the Bookmakers' Committee and expresses no view.

C.3.22 The HBLB has carried out a study[230] which uses the 47th Levy Scheme to develop scenarios which indicates that for the 47th Levy:

- 58% of the LBOs fell under the threshold and hence had an abated Levy rate;
- If an ownership-based Levy scheme had applied to the 47th Levy, the Levy yield would have been in the region of £6.2m higher; and
- If the Levy had an ownership based scheme without thresholds, the Levy yield could have been £6.7m higher[231].

C.3.23 It was the contention of The Bookmakers' Committee's representatives[232] on the Review Group that the impact of the abolition of thresholds, or the reduction of thresholds, would be an increase in the closure of LBOs.

C.3.24 This study suggests that new shops opening will affect the footfall of existing shops in the same catchment area,[233] and hence reduce gross win and profits

[229] The covering letter to The 50th Levy Scheme – Recommendations by the Bookmakers' Committee. paragraph 6.2.
[230] Report of the Thresholds and Levy Incentivisation Review Group, May 2010, pages 3-5.
[231] Report of the Thresholds and Levy Incentivisation Review Group, May 2010, pages 4-5.
[232] Report of the Thresholds and Levy Incentivisation Review Group, May 2010, pages 3.

per shop, and increase the possibility of more LBOs falling under the threshold. Racing echoes this view in its submission for the 50th Levy Scheme[234].

C.3.25 Given the views of both parties we have not explored this option further other than in our analysis of financial scenarios[235].

Foreign racing and other products

C.3.26 We discussed with Racing and Bookmakers whether the base on which Levy is charged should be widened so as to include other betting products beyond British horseracing as at present.

C.3.27 Racing, as noted above, proposes expanding the base on which Levy is charged to include:

- foreign racing; and
- based on the ‘convoyed sales’ argument,[236] FOBTs and virtual racing.

C.3.28 Racing argues that foreign racing should be reintroduced for the 50th Levy Scheme to ensure that the Scheme can achieve a reasonable return and the target yield, noting that it was included in previous schemes[237].

C.3.29 Racing further argues that the inclusion of foreign racing within the scope of the Levy would enable Racing to reduce existing unprofitable British horseracing fixtures as they could be replaced by other leviable product, foreign races, so as to maintain the Levy yield.

C.3.30 Bookmakers consider the Levy scope should be restricted to British horseracing only. We asked the Bookmakers whether, if the Levy percentage rates were adjusted so that each basis generated similar amounts of Levy, they

---

[233] Report of the Thresholds and Levy Incentivisation Review Group, May 2010, pages 3.
[234] 50th Horserace Betting Levy Scheme, submission of British Horseracing, March 2010, page 51. *‘...the move away from a ‘demand’ test for the opening of new LBOs has raised the possibility of multiple LBOs operating in close proximity to each other, without a proportionate increase in total betting activity, leading to the consequence that there is a higher likelihood of each shop falling under the threshold and paying an abated rate of Levy and thereby reducing total yield.’*
[235] Appendix E.
[236] See B5.60 to B 5.66.
[237] 50th Horserace Betting Levy Scheme, submission of British Horseracing, March 2010, page 8.

would prefer a scheme based only on British horseracing or one that included both British and foreign horseracing.

C.3.31 The Bookmakers stated that even with an adjustment to Levy rates they would prefer that the Levy be based on British horseracing only.

C.3.32 In relation to both foreign racing and other betting products, the Bookmakers argue that Racing should not receive Levy income on a ‘product’ it is not producing and that the Levy should be restricted to British horseracing, being the ‘product’ provided by Racing. The 1959 Peppiatt Report indicates that the Levy was *“directed towards those Bookmakers involved in British horseracing.”* and that, *“......horseracing is part of the British way of life...”* The responses to the Peppiatt Report on 23rd May 1960 from Mr. Eric Johnson (Manchester Blackley) also focuses on British horseracing: *“Racing is a traditional feature of our national life........”*.

C.3.33 These historical references might indicate that the Levy was meant to be based on British horseracing. However, the wording of the Statute [238] does not limit the Levy to British horseracing and we note that until the 41st Levy, the Levy was applied to foreign horseracing.

C.3.34 Regarding the possible substitution of unprofitable British fixtures with foreign racing, Bookmakers note that:

- they believe that only around 30 foreign fixtures are run at appropriate times to act as direct substitutes for British races due to time zone issues; and

- given that punters do not understand foreign racing[239] they would bet significantly less on it than they would on British horseracing, reducing the levy take per race.

[238] Betting, Gaming and Lotteries Act 1963, section 27.

[239] Bookmakers in interviews noted that Racing is a complex betting product and punters required a knowledge of horses, trainers, jockeys, race tracks, track conditions to bet and this knowledge did not in general extend to foreign racing.

C.3.35 Bookmakers reject Racing's convoyed sales argument[240] and cite as evidence the Venn diagram reproduced in the Bookmakers' Submission[241].

C.3.36 We consider that the evidence available is inconclusive on the argument of one-way or two-way substitution.

C.3.37 We note that foreign racing has been included in previous Levy schemes[242].

C.3.38 There may be pragmatic advantages of including foreign racing within the Levy as a substitute for some British horseracing as suggested by Racing since Racing would incur no costs on holding these fixtures while benefiting from Levy income (although we note Bookmakers argue that these advantages are quite limited).

C.3.39 Horses entered by Racing in foreign races do not presently generate any Levy. It is however also the case that foreign trained horses run in Britain and betting on such horses placed in Britain will be captured within the existing Levy scope, although the relative value of these amounts is not known.

C.4 BETTING EXCHANGES

C.4.1 Our terms of reference specifically exclude consideration of Betting Exchanges other than including anticipated Betting Exchange Levy contributions in the analysis of possible outcomes for the 50th Levy as the HBLB is undertaking a consultation exercise on Betting Exchanges. We have therefore not considered Betting Exchanges in any detail, but for assistance have set out below the major points made by Racing and Bookmakers in their submissions.

C.4.2 At present Betting Exchanges pay a levy of 10% of their gross profit on British horseracing business where gross profit is defined as the commission deducted by the exchange from the amounts paid out by it to bettors and bet-takers.

---

240 See B 5.62 to B 5.66 for a fuller discussion of 'convoyed sales'.

241 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, .Figure 7 and paragraph 4.20.

242 But not since the 41st Levy Scheme.

Racing's views

C.4.3 Racing notes that Betting Exchanges, although classified as Bookmakers, do not have to be levied at the same rates as traditional Bookmakers and cites the examples of on-course bookmakers and spread betting companies who pay on a different basis[243]. Racing further distinguishes Betting Exchanges and 'traditional bookmakers' noting *".......they perform very different roles and derive their income from betting on Racing in very different ways.*[244]".

C.4.4 Racing further advances the argument that *".....it seems certain that there are many exchange customers who are acting as "bookmakers" within the Levy legislation and, therefore, have an obligation to pay the Levy which, in accordance with the 48th Scheme, would be at 10% of Gross Profits on their British Horserace Betting Business."*[245] and suggests that the 50th Levy Scheme should be designed to collect Levy from these individuals on the basis suggested.

Bookmakers' views

C.4.5 The Bookmakers' Committee expressed no views on Betting Exchanges other than to set out in their recommendations for the 50th Levy Scheme rate to apply to Betting Exchanges[246].

C.4.6 In Bookmaking interviews we were informed that the spread of Betting Exchanges had negatively impacted British horseracing gross win which in turn had reduced Levy yield. This effect was recognised after on course bookmakers were permitted to hedge using betting exchanges.

---

243 50th Horserace Betting Levy Scheme, submission of British Horseracing, March 2010, page 51 section 5.4, "*Whilst exchange operators and traditional bookmaking operators are both "bookmakers" for Levy purposes within the 1963 Act definition there is no reason why both should have to pay the same percentage of their respective horseracing profit (commission for exchanges and gross win for traditional bookmakers) or indeed for their Levy obligation to be based on their "gross profit" at all. For example, on-course bookmakers and spread betting companies are "bookmakers" who pay Levy on a different basis*."

244 50th Horserace Betting Levy Scheme, submission of British Horseracing, March 2010, page 51 section 5.4.

245 50th Horserace Betting Levy Scheme, submission of British Horseracing, March 2010, page 52 section 5.4.

246 The 50th Levy Scheme – Recommendations by the Bookmakers' Committee, paragraph 7.4, "*Rates: Betting Exchanges. We recommend that betting exchanges should continue to be assessed for levy on the basis of 10% of their gross profit on British horseracing business, where gross profit is defined as the commission deducted by the exchange from the amounts paid out by it to bettors and bet-takers.*

C.4.7 We note that the William Hill Annual Report and Accounts 2009 record that telephone betting revenues have declined, in part due to betting exchanges.[247]

C.4.8 If the GAMs were of the view that media costs are a relevant factor in determining the capacity of bookmakers to pay Levy, then we note that Betting Exchanges may incur proportionally lower media costs than LBOs.

[247] William Hill PLC Annual Report and Accounts 2009, pages 4 and 8.

APPENDIX D

IMPACT OF THE ECONOMIC, FISCAL AND SOCIAL ENVIRONMENT

D.1 INTRODUCTION

D.1.1 It is necessary to take account of the economic, fiscal and social environment when agreeing the Levy Scheme[248]. Both Racing and Bookmakers have been, and will continue to be, adversely affected by the current economic environment.

D.1.2 We consider the economic and fiscal environment on both Racing and Bookmakers looking specifically at the likely impact of the forthcoming increase in the standard rate of VAT, the potential for racecourse and LBO closures, the impact of rising costs and the associated social impacts.

D.2 ECONOMIC AND FISCAL CONSIDERATIONS

Increase in the standard rate of VAT

D.2.1 The Government has announced an increase in the standard rate of VAT from its current level of 17.5% to 20% from 4 January 2011[249] and, assuming the Government does not subsequently change the rate of VAT, this rate will apply for the duration of the 50th Levy Scheme.

D.2.2 The majority of the goods and services provided by racecourses are subject to standard rated VAT and the major impact of the rate increase will be to increase the price of some goods and services. Racecourses could either choose to absorb these increases thereby reducing profits, or increase prices, which might put attendance figures at risk. Racing [250]notes that in the present economic climate there must be some doubt that increased costs could be

---

[248] Letter from HBLB to Minister for Sport, DCMS, dated 30 April 2009.
[249] HM Revenue and Customs, http://www.hmrc.gov.uk/vat/forms-rates/rates/rate-increase.htm.
[250] Racing response to question.

passed on and has confirmed that it does not have the data available to quantify the likely effect[251].

D.2.3 Racehorse owners, defined by HM Revenue and Customs as including breeders, dealers, trainers and racing clubs, are granted a dispensation through the VAT registration scheme for racehorse owners[252] allowing owners to register for VAT and thus reclaim input VAT.

D.2.4 Although racecourses and racehorse owners reclaim VAT, the increased rate will impact customers and other members of Racing who are not VAT registered.

D.2.5 The impact on Bookmakers may be more significant as they will face increased levels of irrecoverable VAT due to the fact that betting and gaming services are VAT exempt[253] limiting their ability to reclaim input VAT. It has been "*recognised that the Betting Industry contributes a significant level of VAT which cannot be reclaimed (£209 million in 2008).*"[254]

D.2.6 The Bookmakers' Committee estimates the impact of the increase in VAT at £47 million per annum. If the inflationary adjustment in the calculation is removed the increase reduces to £35m[255].

Racecourse and Bookmaking shop closures

D.2.7 We have received anecdotal evidence of job losses in all aspects of Racing[256].

D.2.8 In recent years there have been no closures of racecourses with the exception of Great Leighs, whose failure Bookmakers relate to a flawed business model. Even in the recessions of the 1970's, 1980's and 1990's there was only one

[251] Given income of approximately £500m from sources other than owners the effect of a 2.5% increase in VAT could be to increase costs by£12.5m.
[252] HMRC: Registration scheme for racehorse owners, HM Revenue and Customs. http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&id=HMCE_CL_000096&propertyType=document.
[253] HMRC: Rates of VAT on different goods and services – Sport, leisure, culture and antiques. HM Revenue and Customs http://www.hmrc.gov.uk/vat/forms-rates/rates/goods-services.htm#2.
[254] An Economic Impact of the British Betting Industry dated January 2010, page 20.
[255] On the basis of £209m of unclaimed VAT in 2008 (see above) when VAT was 17.5% then the effect of the increase to 20% in 2010 would be to proportionally increase the unclaimed amount by £30m.
[256] Racing interview.

racecourse closure (Stockton on Tees)[257] and in 2009 a new racecourse was opened in Wales at Ffos Las. This lack of closures is unusual for an industry to experience.

D.2.9 Racecourse annual accounts, such as those for Arena Leisure Plc, illustrate expectations for falling revenues from corporate and private hospitality[258]. Smaller racecourses are coping with the recessionary impact in a number of ways, including the capping of prize money[259].

D.2.10 Racing has not quantified the impact of less prize money on the industry[260] but has impressed upon us its view that lowering prize money could be a significant risk to securing the continued contribution and participation of owners and breeders in British horseracing.

D.2.11 We note that the number of LBOs has decreased[261] (there have been some LBO openings to offset the closures but overall the number has reduced) and Bookmakers are facing reduced gross win[262]. Large Bookmakers do, however, have more opportunities to adjust their business models (compared to Racing) by growing the internet market, expanding their product range or taking advantage of offshore channels.

D.2.12 The Bookmakers' Committee noted, in its submission for the 50th Levy Scheme, a lack of positive economic outlook for the future, with anticipated

---

[257] Bookmakers interview.

[258] Arena Leisure Plc, Results for six months ended 30 June 2010, Arena Leisure Plc, page 2. 'Corporate and private hospitality revenues continue to be susceptible to the economic conditions, however, the period has seen a moderate improvement in hospitality attendances to 17,000 (2009: 15,000). We remain cautious about the outlook in terms of both attendance numbers and spend per head for this important revenue segment which (sic. remove 'which') remains some way off the peak levels of 2007 and 2008.'

[259] Thirsk Racecourse Limited, Report and Financial Statements, 31 March 2009, Thirsk Racecourses Limited page 3. '*Where possible, staff levels have been rationalised, the company's contribution towards Prize Money has been capped, and day-to-day expenses are constantly under review.'*

[260] Impact on Racing of 2011 Levy income forecasts at £68.8m, page 12. *'The likelihood and impact and way in which major owning and breeding operations may react is unknown and has not been tested, but would be potentially considerable in terms of scale.'*

[261] Responses to HBLB questions from GAM.

[262] The 50th Levy Scheme Recommendations by the Bookmakers' Committee dated 14 July 2010, The Bookmakers' Committee, page 17, paragraph 4.31, figure 10.

rises in inflation and interest rates, decreases in expenditure and the increased (non-recoverable) VAT burden faced by Bookmakers from 2011[263].

D.2.13 Both Racing and Bookmakers informed us that they believe that they have not been hit harder than other industries by the recession[264].

D.3 SOCIAL CONSIDERATIONS

D.3.1 At an industry level, the greatest effect in job losses is often felt at the junior level (in this case stable staff, jockeys and LBO staff).

D.3.2 The reduction in prize money noted above will impact stable staff and jockeys as the reduction has a direct ‘trickle down’ impact. Racing expects that with a further reduction in prize money, there will be redundancies since training is labour intensive and wages usually account for about 50% of training costs[265].

D.3.3 Aspects of Racing tend to be embedded in the local community and in some areas the effects of any losses will be more greatly felt in the local region.

D.3.4 For the benefit of these members within Racing, HBLB may want to give consideration to the merits of re-directing Levy to support the weakest participants.

D.3.5 Bookmakers also tend to employ a large number of unskilled workers[266], and thus reductions to Bookmakers’ profits may also have social consequences.

D.4 COMMENT

D.4.1 Both Racing and Bookmaking have suffered and will continue to suffer through the economic downturn. The only specific additional factor identified that will impact the 50th Levy is the increase in VAT to 20% which will have an adverse impact on both Bookmakers and racecourses.

---

263 The 50th Levy Scheme Recommendations by the Bookmakers’ Committee dated 14 July 2010, The Bookmakers’ Committee, pages 20-22.

264 Bookmakers interviews.

265 Impact on Racing of 2011 Levy income forecasts at £68.8m, page 9. ‘...With wage costs typically 50% or more of total costs, as training is labour intensive, it is obvious that costs [sic. cost] savings will come from redundancies...’

266 An Economic Impact of the British Betting Industry dated January 2010, page 31.

APPENDIX E

LEVY SCENARIOS

E.1 INTRODUCTION

E.1.1 We set out below Levy scenarios which compare the various Levy scheme suggestions for the 50th Levy Scheme presented to us by, and discussed with, Racing, Bookmakers and HBLB during the course of our work.

E.1.2 The scenarios are based on estimates of the final yield from 48th Levy scheme, and discussions with the HBLB on likely Levy yield trends. They provide illustrations of what the yield of the 50th Levy could be and are not intended to be estimates of the likely yield.

E.1.3 We modelled the following scenarios for the 50th Levy Scheme:

- Basic forecast with thresholds;
- Basic forecast with no thresholds;
- Inclusion of foreign racing with thresholds;
- Inclusion of foreign racing with no thresholds;
- Adjusting rates to yield £60m (Basic forecast) with the inclusion of foreign racing;
- Adjusting rates to capture amounts not captured offshore;
- Adjusting thresholds for changes in gross win with no allowance for increased media costs;
- Adjusting thresholds for changes in gross win with allowance for increased media costs;
- Adjusting rates to yield £130m;
- Adjusting rates to yield £130m with no thresholds;
- Applying thresholds on a company basis;
- Applying thresholds on an aggregated basis; and
- Rollover of 49th Levy Scheme.

E.1.4 All 50th Levy Scheme scenario figures for LBOs are generated from the actual 48th Levy Scheme Form of Declaration returns ("FODs") received by HBLB as at 15 September 2010[267]. We understand that while not all returns had been submitted to HBLB at that date, those returned represent over 97% by volume and include returns from all major Bookmakers. We have used the figures for the 48th Levy Scheme as it is the most recent Levy Scheme with available data of actual receipts.

E.1.5 All 50th Levy Scheme scenario figures for other betting platforms are as provided by HBLB for the 48th Levy Scheme.

E.1.6 The 50th Levy Scheme scenarios include an adjustment to the 48th Levy Scheme figures for all leviable platforms as provided by HBLB. This adjustment was estimated to reflect known changes since April 2010 such as the impact of firms moving offshore and an estimated figure for Forms of Declaration not yet received.

E.1.7 HBLB provided further adjustments in order to allow a range of yields to be modelled for each scenario: from a 'top of range' case (no further adjustments), via a 'middle of range' case[268] to a 'bottom of range' case[269]. We have based all our scenarios on the middle of range case except for the basic forecast in E2 where we provide all three.

E.2 BASIC FORECAST FOR THE 50TH LEVY SCHEME

E.2.1 This scenario is based on the Bookmakers' recommendations, set out in the Bookmakers' Committee's submission[270], for a 10% Levy percentage rate applied to gross win of LBOs, telephone betting, online betting and other

---

[267] Information for the 48th Levy Scheme Form of Declaration returns for 8,226 LBOs was provided by HBLB as at 15 September 2010.

[268] The percentage reductions applied to the 48th Levy Scheme 'top of range' case figures for each platform to estimate the 'middle of range' case were: 3% for internet; 10% for telephone; 6% for LBOs;3% for Betting Exchanges and 6% for other (leviable) betting platforms.

[269] The percentage reductions applied to the 48th Levy Scheme 'top of range' figures for each platform to estimate the 'bottom of range' case were: 5% for internet; 20% for telephone; 12% for LBOs; 12% for Betting Exchanges; and 5% for other (leviable) betting platforms.

[270] The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 26, paragraph 7.2.

leviable services provided by Bookmakers and a £123,000 threshold to be applied to each LBO's gross win.

E.2.2 This scenario produces estimated yields of £64m, £60m and £56m for top of range, middle of range and bottom of range case scenarios respectively.

E.2.3 The middle of range case scenario estimated yield of £60m is the figure that should be used for comparison with the other scenarios set out in this Appendix.

E.3 BASIC FORECAST WITH NO THRESHOLDS

E.3.1 This scenario is modelled on the same basis as the Basic Forecast above except we have set the threshold at £nil[271].

E.3.2 This scenario produces an estimated yield of £77m.

E.4 INCLUSION OF FOREIGN RACING WITH THRESHOLDS

E.4.1 This scenario is modelled on the same basis as the Basic Forecast except we have included the gross win on foreign horseracing using the recommendations set out in Racing's submission for the 50th Levy scheme[272].

E.4.2 We obtained the figures for foreign horseracing from the 2010 Ernst & Young report[273] for British and foreign horseracing as a proportion of gross win from all betting products (including gaming machines) for all betting platforms. This indicated that overseas betting formed 4.42% of total gross win (including FOBTs) for 2009 and British horserace betting formed 23.27% of total gross win (including FOBTs) for 2009.

E.4.3 This scenario assumes the same percentage of foreign horseracing betting would occur on internet and telephone betting platforms as LBOs. HBLB has advised us that the percentage of betting on foreign horseracing on non-LBO

[271] 50th Horserace Betting Levy Scheme, British Horseracing submission dated March 2010, page 49.
[272] 50th Horserace Betting Levy Scheme, British Horseracing submission dated March 2010 page 8 section I.
[273] 50th Horserace Betting Levy Scheme Report for the Bookmakers' Committee -Analysis Update, Ernst & Young, page 3, figures 2, 3 & 4 received 15 October 2010..

platforms is likely to be lower than that calculated in this scenario[274]. This is based on the view that punters prefer to bet on events they can watch and most foreign horseracing can only be viewed in an LBO. If this is so, it will lower the yield we have estimated. However this will be offset by the impact of including an element of foreign racing for each LBO which could move some LBOs above the threshold and others would face a higher marginal percentage levy rate (in the event all LBOs moved above the threshold the effect would be to increase the yield by £3m.)

E.4.4 This scenario produces an estimated total yield of £71m which indicates on the middle of range case scenario a yield for foreign racing of £11m.

E.5 INCLUSION OF FOREIGN RACING WITHOUT THRESHOLDS

E.5.1 This scenario is modelled on the same basis as the Inclusion of Foreign Racing with Thresholds except we have set the threshold at £nil[275].

E.5.2 This scenario produces an estimated yield of £91m.

E.6 ADJUSTING RATES TO YIELD £60M (BASIC FORECAST) WITH THE INCLUSION OF FOREIGN RACING

E.6.1 This scenario illustrates the 50th Levy Scheme levy percentage rate required to yield the Basic forecast of £60m assuming that foreign horseracing is included in the leviable gross win.

E.6.2 We have therefore assumed that the Levy percentage rate on all leviable platforms could be reduced if foreign horseracing was included in the 50th Levy Scheme. The threshold level applied to LBO gross win is £123,000, as recommended by the Bookmakers' Committee in its submission for the 50th Levy Scheme[276]. As above we generated this scenario using the 2010 Ernst &

[274] HBLB advised that foreign horseracing betting figures are likely to be weighted 95% towards LBO betting and 5% towards other leviable platforms.
[275] 50th Horserace Betting Levy Scheme, British Horseracing submission dated March 2010, page 49.
[276] The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 26, paragraph 7.2.

Young report figures[277] for British and foreign horseracing as a proportion of gross win from betting products for all betting platforms.

E.6.3 This scenario indicates that the application of an estimated Levy percentage rate of 9%[278], when applied to the gross win of LBOs, telephone betting, online betting and other leviable Bookmaking products, would produce an estimated yield of £62m.

E.7 ADJUSTING RATES TO CAPTURE AMOUNTS NOT CAPTURED OFFSHORE

E.7.1 This scenario illustrates the 50th Levy Scheme levy percentage rate required to achieve the same yield as would have been achieved with a 10% levy on previously leviable gross win transferred offshore. It is otherwise based on the same assumptions as the Basic Forecast.

E.7.2 This scenario is modelled using an adjustment for the impact of the estimated total yield lost due to Bookmaker transfers offshore based on the Levy payments made in the last full year before they moved offshore[279]. This adjustment does not include amounts for operators who have never been onshore.

E.7.3 This scenario produces an estimated Levy percentage rate of 11% which, when applied to gross win of LBOs, telephone betting, online betting and other leviable Bookmaking services, and generates an estimated yield of £66m.

E.8 ADJUSTING THRESHOLDS FOR CHANGES IN GROSS WIN WITH NO ALLOWANCE FOR INCREASED MEDIA COSTS

E.8.1 This scenario illustrates the 50th Levy Scheme yield generated by making an adjustment of thresholds from the 42nd Levy Scheme for inflation since that

277 50th Horserace Betting Levy Scheme Report for the Bookmakers' Committee -Analysis Update, Ernst & Young, page 3, figure 2, 3 & 4 received 15 October 2010.

278 We have set the levy percentage rate at a whole number hence the estimated yield of £62m and not £60m.

279 Estimate provided by HBLB.

time and taking account of the relative reduction of horseracing gross win as a percentage of total Bookmaking gross win during that period.

E.8.2 We generated this scenario on the assumption that the £75,000 threshold from the 42nd Levy Scheme[280], which was the Scheme where thresholds were reduced for the removal of overseas racing[281], was the appropriate threshold to be adjusted. We then applied a Levy percentage rate of 10% to gross win of LBOs, telephone betting, online betting and other leviable services provided by Bookmakers, as recommended by the Bookmakers' Committee in their submission for the 50th Levy Scheme[282].

E.8.3 We grossed up the £75,000 threshold (which relates to horseracing gross win only) to represent a threshold for total Bookmaking gross win (including FOBTs) in 2003[283], uplifted the resulting value for inflation[284], and then adjusted back to obtain a threshold figure for horserace gross win only as a proportion of total Bookmaking gross win (including FOBTs) in 2009[285].

E.8.4 Based on RPI for inflation[286], this scenario produces an estimated Levy threshold of £51,100 and an associated yield of £74m.

E.8.5 Based on CPI for inflation[287], this scenario produces an estimated Levy threshold of £49,000 and an associated yield of £74m.

---

280 HBLB Forty-Second Levy Scheme 1st April 2003 to 31st March 2004.

281 Otton III: Consultant's Advice to the Horserace Betting Levy Board dated 12 December 2008, Rt. Hon. Sir Philip Otton, page 12, paragraph 33.

282 The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 26, paragraph 7.2.

283 An Economic Impact of the British Betting Industry dated January 2010, page 38 horseracing gross win for 2002/03 £858m and total gross win £2,026m.

284 RPI and CPI figures for April 2003 and July 2010 were taken from the ONS website, as specified in the relevant footnotes below.

285 50th Horserace Betting Levy Scheme Report for the Bookmakers' Committee -Analysis Update, Ernst & Young, page 3, figure 2& 4 received 15 October 2010.

286 ONS website: RPI for inflation was indexed at 181.2 in April 2003 and at 224.5 in August 2010.

287 ONS website: CPI for inflation was indexed at 96.7 in April 2003 and at 114.9 in August 2010.

E.9 ADJUSTING THRESHOLDS FOR CHANGES IN GROSS WIN WITH ALLOWANCE FOR MEDIA COSTS

E.9.1 This scenario is modelled on the same basis as above (adjusting thresholds for changes in gross win with no allowance for media costs) except it assumes that all LBOs pay for media from both Turf TV and SIS.

E.9.2 Although HBLB advised us that there are a minority of firms who only subscribe to one media provider, for example Chisholm Bookmakers Limited which only subscribes to SIS, we have assumed all LBOs are paying for coverage from both SIS and Turf TV.

E.9.3 We are advised that the average annual media cost is £23,000[288] per LBO. The Bookmakers' Committee's submission on 15 October 2010[289] indicated that 90% of the costs of Turf TV and 65% of the costs of SIS related to British horseracing with a total cost per shop of £15,400[290] relating to British horseracing.

E.9.4 LBOs did pay for media costs in 2002, but we have no information as to how much. If the costs of media rights at that time were included in this calculation so that only increased media costs were taken into account, the thresholds calculated would be lower than those shown here, with a consequent increase in the associated yield.

E.9.5 Based on RPI for inflation[291], this scenario produces an estimated Levy threshold of £66,500 and an associated yield of £70m.

E.9.6 Based on CPI for inflation[292], this scenario produces an estimated Levy threshold of £64,400 and an associated yield of £71m.

---

288 The 50th Levy Scheme. Recommendations by the Bookmakers' Committee, page 17, paragraph 4.28. The cost includes VAT.
289 Letter dated 15 October 2010 from Will Roseff to Paul Lee.
290 We note that this figure is slightly less than the value calculated applying the percentages set out to £23,000 reflecting that not all LBOs take both Turf TV and SIS.
291 ONS website: RPI for inflation was indexed at 181.2 in April 2003 and at 224.5 in August 2010.
292 ONS website: CPI for inflation was indexed at 96.7 in April 2003 and at 114.9 in August 2010.

E.10 ADJUSTING RATES TO RAISE £130M

E.10.1 This scenario illustrates the 50th Levy Scheme levy rate required such that 50th Levy Scheme yield is £130m, which is the lower limit of the £130m-£150m recommended by Racing in its submission for the 50th Levy Scheme[293]. The Levy threshold level applied to LBO gross win is £123,000, as recommended by the Bookmakers' Committee in their submission for the 50th Levy Scheme[294].

E.10.2 This scenario indicates an estimated Levy percentage rate of 22%, applied to gross win of LBOs, telephone betting, online betting and other leviable Bookmaking services with an estimated yield of £129m.

E.10.3 We note that in practice the Levy percentage rate would have to be higher to raise £130m so as to account for changes in Bookmaker behaviour (e.g. moving offshore or choosing not to provide, or to provide less, leviable British horserace betting products) and Bookmakers that would go out of business.

E.11 ADJUSTING RATES TO RAISE £130M WITH NO THRESHOLDS

E.11.1 This scenario is as above (adjusting rates to raise £130m) except the threshold is set to £nil.

E.11.2 This scenario indicates an estimated Levy percentage rate of 17%, applied to gross win of LBOs, telephone betting, online betting and other leviable Bookmaking services with an estimated yield of £129m.

E.11.3 As noted above, in practice the Levy percentage rate would have to be higher to raise £130m so as to account for changes in Bookmaker behaviour (e.g. moving offshore or choosing not to provide, or to provide less, leviable British horserace betting products) and Bookmakers that would go out of business.

---

293 50th Horserace Betting Levy Scheme, British Horseracing submission dated March 2010, pages 1 and 3.

294 The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 26, paragraph 7.2.

E.12 APPLYING THRESHOLDS ON A COMPANY BASIS

E.12.1 This scenario illustrates the yield generated on the assumption that a threshold of £123,000 is applied on a company rather than on a shop (LBO) basis which, when exceeded, would subject the remainder of the company's gross win to a 10% Levy percentage rate as set out in the Bookmakers' Committee's submission[295]. Abatement continues to apply as at present.

E.12.2 This scenario produces an estimated yield of £76m.

E.13 APPLYING THRESHOLDS ON AN AGGREGATED BASIS

E.13.1 This scenario illustrates the yield generated on the assumption that a threshold of £123,000 per shop is applied on an aggregated basis for each Betting company based on the number of shops (LBOs) held by each company with the total allowance applied against total company gross win and a 10% Levy percentage rate set out in the Bookmakers' Committee's submission[296]. For example, a company with two shops would have its combined profits assessed against a threshold of £246,000 (i.e. two £123,000 thresholds).

E.13.2 This scenario produces an estimated yield of £56m.

E.14 ROLLOVER OF 49TH LEVY SCHEME

E.14.1 This scenario illustrates the yield generated on the assumption that there is a rollover of the 49th Scheme: a 10% Levy percentage rate applied to gross win of LBOs, telephone betting, online betting and other leviable services provided by Bookmakers and a £93,000 threshold[297] to be applied to each LBO's gross win.

E.14.2 This scenario produces an estimated yield of £67m.

---

295 The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 26, paragraph 7.2.

296 The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 26, paragraph 7.2.

297 £88,740 threshold for 49th Scheme adjusted for RPI for the 12 months ended 31 July 2010. ONS website: RPI percentage change over 12 months ended 31 July 2010 is 4.8%.

E.14.3 Table E1 below summarises the Levy scenarios with their relevant Levy percentage rates, thresholds and estimated yields for ease of comparison.

Table E13.1

Levy Scenario	**Levy percentage rate**	**Levy threshold**	**Estimated 'middle of range' case scenario - 50th Levy Scheme yield**
Basic forecast with thresholds	10%	£123,000	£60m
Basic forecast with no thresholds	10%	£nil	£77m
Inclusion of foreign racing with thresholds	10%	£123,000	£71m
Inclusion of foreign racing with thresholds	10%	£nil	£91m
Adjusting rates to yield £60m (Basic forecast) with the inclusion of foreign racing	9%	£123,000	£62m
Adjusting rates to capture amounts not captured offshore	11%	£123,000	£66m
Adjusting thresholds for changes in gross win with no allowance for media costs	10%	£51,100 (RPI) £49,000 (CPI)	£75m £75m
Adjusting thresholds for changes in gross win with allowance for media costs	10%	£66,500 (RPI) £64,400 (CPI)	£73m £73m
Adjusting rates to achieve yield of £130m	22%	£123,000	£129m
Adjusting rates to achieve yield of £130m with no thresholds	17%	£nil	£129m
Applying thresholds on a company basis	10%	£123,000	£76m
Applying thresholds on an aggregated basis	10%	£123,000	£56m
Rollover of 49th Levy Scheme	10%	£93,000	£67m

APPENDIX F

F.1 OTHER OBSERVATIONS

F.1.1 We have identified five other areas that the GAMs may wish to explore further. These issues impact the 50th Levy and have longer term implications for Racing and Bookmakers

F.2 DISTRIBUTION OF THE LEVY BETWEEN PRIZE MONEY AND INTEGRITY AND REGULATION

F.2.1 The HBLB has good visibility on the use of its contributions to prize money but much less visibility on integrity and regulation spending.

F.2.2 Under the existing process the HBLB pays the BHA and the BHA and racecourses decide on how to execute / commission integrity activities. Consequently those planning, executing and benefiting from these services do not bear the costs which may mean that the services commissioned may not provided in the most cost effective manner. Racing argues that the current process does achieve cost effectiveness as racecourses and other Racing participants challenge the BHA on costs[298].

F.2.3 If the process were amended so that those executing or commissioning these services had at least some financial interest in costs, it would provide more comfort to the HBLB that these services were being provided cost effectively. A revision of the process might involve racecourses meeting some of the costs directly which could impact on the financial performance of smaller racecourses.

F.2.4 Racing observed in our interviews that cutting integrity could result in a reduction in the cancellation of low quality races which are precisely those that Bookmakers favour to maximise gross win.

---

[298] Racing interviews.

F.3 HOLISTIC FIXTURE ECONOMIC REVIEW

F.3.1 The HBLB is now in receipt of data that allows the identification of fixtures that are levy positive[299]. As data builds in the longer term, the HBLB will benefit from a comprehensive analysis of the economic viability of all fixtures including the profitability of the fixture for the racecourse.

F.3.2 This analysis should be established through a matrix which enables the HBLB to identify an optimal mix of fixtures which could be based on a combination of the following criteria:

- Maximising Levy generation;
- Maximising fixture profitability; and
- Minimising owners' costs.

F.3.3 This is likely to be a complex analysis due to the impact of cross-subsidisation of fixtures and the impact of social and cultural factors on the 'optimal' fixture list. It may be that certain fixtures should be maintained regardless of profitability to protect the viability of a racecourse and the local area.

F.3.4 The data collection for the analysis is likely to take a number of years as it will be necessary to avoid distortions that may be caused by random factors such as weather or transport strikes.

F.4 FUTURE OF MEDIA RIGHTS

F.4.1 We note that many of the racecourses have signed contracts with Turf TV until 2018 committing the media provider to an agreed expenditure stream. However we understand that the LBOs do not have similar 'back to back' contracts to buy the pictures from Turf TV, these contracts in the case of the 'Big 3' running only until 2013[300]. This mismatch creates a risk for the media

[299] i.e. fixtures where the levy generated exceeds all HBLB contributions to support the fixture including prize money.

[300] We do not have details of the corresponding contractual arrangements with SIS.

provider in the event that it is unable to agree contracts with Bookmakers at a level that covers its committed expenditure stream.

F.4.2 This position may be exacerbated by the parties' expectations of the value of media rights. In our interviews Racing stated that it believed that there was potential for media rights payments to continue to increase; however, Bookmakers disagreed with this and believe that, if anything, they are more likely to fall. This situation creates uncertainty on the future of media rights income for Racing.

F.5 LEAKAGE

F.5.1 Although there have been discussions during the life of the Levy as to how it might be replaced, it remains the purest way to transfer funds from Betting to Racing there being only minimal leakage[301] due to costs of running the HBLB. In particular the fact that VAT is not payable on any Levy contributions to Racing means that any commercial alternative is likely to add at least 20% to leakage. In addition the Capital Fund and Capital Credit Scheme operate as tax efficient ways of financing racecourse development.

F.5.2 In contrast media payments suffer a high level of leakage[302] with only £1 reaching racecourses for every £3 to £4 paid by Bookmakers[303].

F.6 FOCUS OF PRIZE MONEY

F.6.1 With a potential reduction in Levy there may be a need to fine tune which fixtures receive prize money, the value of that prize money and the races on which it is focussed. Racing and Bookmakers have very different views on this focus which reflects their views on the type of racing they prefer. Bookmakers believe that quality racing (by their definition – large fields, close

---

[301] By which we mean the difference between the amounts paid by Bookmakers and the amounts received by Racing.

[302] While we have not investigated the cause of the leakage in detail it is likely to represent the cost of providing the services and the return on capital required by providers of capital.

[303] The 50th Levy Scheme - Recommendations by the Bookmakers' Committee, page 12, paragraph 4.6.4 *"£56.1m received by racing (racecourses for media rights in FY09/10*" and page 17, paragraph 4.29 "*The annual cost to the betting industry of providing TV coverage to LBOs is in the order of £200m*.".

finishes) should receive greater Levy support at the expense of the premier race fixtures (quality as defined by Racing) and expressed the view that a 10% reduction in premier prize money for example would support many smaller races.

F.6.2 In support of this Bookmakers argue that premier fixtures are self financing and require limited HBLB support. Racing in contrast believes that high prize money for major races maintains quality racing and incentivises owners not to move horses abroad.

G.1 KEY FEATURES OF THE 41ST TO 49TH LEVY SCHEMES.

G.1.1 We set out the key features of the 41st to 49th Levy Schemes below:

Table G1.1

Levy Scheme	Threshold	Levy percentage rate	British horserace betting only	Reached by determination
41st	150,000	10	No	Yes
42nd	75,000	10	Yes	No
43rd	75,000	10	Yes	No
44th	75,000	10	Yes	No
45th	80,000	10	Yes	No
46th	82,600	10	Yes	No
47th	85,700	10	Yes	Yes
48th	90,000	10	Yes	No
49th	88,740	10	Yes	No

G.1.2 Since the 41st Levy Scheme the basis of the Levy is little changed apart from adjustments to the thresholds which have for recent Levy Schemes been adjusted for inflation.

H.1 REPRESENTATIVES OF RACING AND BOOKMAKING INTERVIEWED.

H.1.1 We interviewed the follow representatives of Racing, the individuals interviewed were nominated by Racing.

Table H1.1

Representing	Name
BHA	Nic Coward, Chris Brand, Paul Foster
RCA	Stephen Atkin
The Horsemen's Group	Alan Morcombe
Racehorse Owners Association	Michael Harris
Deloitte Sports Business Group	Alan Switzer
The Thoroughbred Breeders' Association	Louise Kemble
National Trainers Federation	Rupert Arnold
Arena Leisure Plc	Ian Renton
Jockey Club Racecourses Limited	Paul Fisher

H.1.3 We interviewed the follow representatives of Bookmaking, the individuals interviewed were nominated by Bookmaking.

Table H1.2

Representing	Name
'Big 3' Bookmakers	Thomas Murphy (William Hill), Christopher Palmer (Ladbrokes), Nick Rust (Gala Coral)
Independent Bookmakers	Will Roseff (Backhouse Bet), Howard Chisholm (Chisholm Bookmakers), Michael Corbett (Corbett Bookmakers), Warwick Bartlett (Bartlett's Bookmakers)
Betting Exchanges	Martin Cruddace (Betfair)
On –course bookmakers	Keith Johnson
Bookmakers' Committee	Stu McInroy (General Secretary Bookmakers' Committee)

H.1.4 We also interviewed Trevor Beaumont and Mike Smith of The Tote and Professor Leighton Vaughan Williams, Professor of Economics and Finance, Director, Betting Research Unit, Nottingham Business School.