

## 50<sup>TH</sup> HORSERACE BETTING LEVY SCHEME

### RACING'S RESPONSE TO THE INDEPENDENT ASSESSMENT BY GOVERNMENT APPOINTED MEMBERS ('ASSESSMENT')

#### 1 GENERAL

Racing is responding to the invitation from the Government Appointed Members to comment on their note, issued on 28<sup>th</sup> September 2010, which included an Annex A. We have also taken the opportunity to comment on the press release issued by the Levy Board on the publication of its annual report, insomuch as it related to the 50<sup>th</sup> Scheme, and articles in the Racing Post of 21<sup>st</sup> October.

We have set out below a series of short comments and questions under a general heading, and then headings for each part of the Annex.

#### 2 SUMMARY

- **GENERAL APPROACH** - In line with the letter from the Levy Board to the Secretary of State on 30 April 2009, the Levy Board should base its Levy assessment on: "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: 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."
- **BOOKMAKERS' COMMITTEE (BC)** - The BC has made no further approaches to Racing or the Levy Board, since the rejection of its offer more than a month ago, and is stating publicly that it has no current intention of changing its position.
- **BC INCONSISTENCIES** - The BC submission fails to address key areas of avoidance or underpayment of Levy, and has been contradicted by public statements by members of the Committee.
- **CAPACITY TO PAY** - The Assessment has failed to address bookmakers capacity to pay, or the solution of the 4 key loopholes identified by Racing
- **TARGET YIELD**- Racing was requested by the Levy Board to identify a target range of Levy income, which would to a significant extent be achieved if the loopholes were properly addressed. Gross win is not a proper benchmark for assessing the quantum of what would be a fair Levy yield, because it is understated by the effect of non-paying offshore bookmakers and business users of betting exchange, with a further damaging impact on the margins achieved by other betting operators. Further, the Levy Board will need to evaluate the projected yield from any further recommendations in the context of its expenditure and reserves requirements.
- **ANNEX 'A'**- Annex 'A' is fundamentally flawed and should not be used as a basis for assessing a fair Levy. We have set out below our detailed comments on the Annex.
- **LBO MEDIA RECEIPTS**. There is, as Sir Philip Otton established, no clear linkage between the Levy and the LBO media receipts, other than as part of bookmakers' capacity to pay, in the context of **all** their income and expenditure. Further, there are a large number of betting operators for which LBO coverage is of no relevance.
- **LBO CLOSURES** - There is no evidence to support the BC's claims that there would be substantial closures in the event of a reintroduction of Levy on overseas horseracing and the removal of thresholds.

### 3 GENERAL APPROACH

It is clear that when assessing the merits of any particular Levy recommendations from the Bookmakers' Committee, the Levy Board is required to take account both the capacity of the betting industry to pay and the needs of horseracing. This was addressed in detail by Sir Philip Otton. We have noted your reference in one instance to Sir Philip Otton, in relation to Racing's 'business case' and look forward to full reference to each of his recommendations and a reasoned assessment of their merits as matters progress.

We consider that it is an error for the GAMs to use Annex 'A' as a basis for assessing what may constitute a reasonable Levy settlement. The information is of course relevant to both the needs of horseracing but alongside all other heads of income and expenditure, which are highlighted in our submission. Further the Independent Assessment has not on its face addressed the capacity of the betting industry to contribute based on **all** their income and expenditure. Media rights are one element of their costs. Further, we find it very difficult to understand how you appear to be saying that you will take into "account", which we have to interpret as meaning **against** the interests of Racing, amounts that might be paid by broadcasters in foreign countries for audio visual rights (ie to give a benefit to betting operators in GB) but not take into account the non-payment of Levy by GB based businesses through their offshore arms (which has the double negative of depressing margin in the GB market). Again this appears to be inconsistent and flawed as an approach.

We welcome the intent of facilitating negotiations and discussions, and to that end await a revised Recommendation from the BC. However, we note the public comment of the BC Chairman in the racing post on 20 October stating that the BC has no plans to submit a revised offer, their original Recommendation being "a most reasonable offer in the circumstances". This is despite, over a month ago at the September meeting, the GAMs confirming to the BC Chairman that that any revised Recommendation would have to move "very far" from the original recommendation that was rejected before being something that could be accepted.

The position of the BC is unreasonable and perverse. This is in itself a deep concern, but is made even more so bearing in mind the significant challenges of planning for 2011. We would urge the GAMs to expedite, in any way they feel able, the process of establishing the fair return to Racing from the Levy.

### 4 BC SUBMISSION

We would continue to highlight that members of, or organisations represented on, the BC have stated publicly that there is a shortfall under the current Scheme and its application, which would be repeated under the BC Recommendation and which they appear incapable of moving from. This is a perverse state of affairs and highlights the unreasonableness of the BC position, particularly in light of the fact that it is only the BC that can formulate a recommendation for consideration by the HBLB. The scale of the unfairness is substantial, and we estimate this as being in the region of an additional potential £50-60m Levy yield.

The shortfall created by the current treatment of betting exchanges has been estimated by William Hill (with two representatives around the BC table, including the Deputy Chairman) at £30m. Betting exchanges and others point to the shortfall created by operators being based offshore and avoiding paying Levy, and thresholds being applied to major operators' betting shops in addition to small businesses, which together we estimate to create a further shortfall of £20-30m.

The BC Recommendation makes no reference to these matters, despite having the perversity of their position pointed out to them. The note dated 28 September highlighted these and other issues which they were to address, and we note that the BC has refused to do so. The current Levy Board forecast, based on information supplied by the BC, for the yield in 2011 if the 49th Scheme terms were repeated is £57m. The BC position is that the only substantive change from the 49th Scheme into the 50th Scheme should be to increase thresholds – it says that nothing should change to the treatment of exchanges, and that no account should be taken of offshore operators (even where these are companies whose senior executives actually sitting around the BC table), despite the public views of its members on the issues that would lead to the levy yield increasing by £50-50m. The Levy Board Executive has confirmed to us that the Bookmakers' Committee recommendation to increase thresholds, which was rejected by the Levy Board in September, could cost a further £14m in Levy yield. On the basis of the Levy Board forecasts therefore, the BC proposal would actually equate to £43m.

Despite BC forecasts that the 49th Scheme is currently yielding nearly 25% less than the outturn for the 48th Scheme, the BC Chairman inferred, as reported in the Racing Post of 21st October, that if the terms of the 49th Scheme were repeated, then the 50th Levy Scheme would yield £74.5m (ie the 48th Scheme figure). This is a gross misrepresentation, as much as his estimate of the cost of the BC's proposal to raise thresholds at £8.5m.

## **5 CAPACITY TO PAY**

We note that we still await any outcome from the Deloitte analysis, and in particular note that we have not received any information from any source (including your Assessment) in relation to "capacity to pay". We also note that the Assessment has been prepared without reference to Deloitte and the detailed analysis they have been retained to carry out.

Whilst the GAMs have expressed a view on the target range proposed by Racing, we are surprised that they have made no comment on the four key loopholes which Racing has identified as needing to be closed and which as a consequence would lift the Levy yield well on the way to the target range we have identified. We submit that the case for taking action in each of these areas is overwhelming and that it is disappointing that the BC has failed to address these issues properly, or in some cases at all.

We were also surprised and disappointed by the press release which accompanied the publication of the Annual Report, in which the Chairman expressed an opinion on one aspect of racecourse income, ie LBO rights income, without reference to the overall profitability of racecourses and the reference to the industry's costs, whilst on the other hand no comment was made on the areas where betting operators either avoid or pay insufficient Levy. As we state above the Levy Board has to have regard in the round to both bookmakers' capacity to pay and the needs of horseracing.

Partly against this backdrop, we note that in the last week William Hill Plc have announced that Group net revenue was up 22% in the third quarter of 2010, and we have seen Betfair float publicly with a market capitalisation of over £1.6bn (shares rising 20% on their first day of trading).

However, given the public position taken by BC that Betting will take the 50<sup>th</sup> Scheme to be determined by the Minister, we now urge the GAMs to use the time before 31<sup>st</sup> October to make their views known – to the Minister, to Racing, and publicly - on the important income related issues that they have to date felt restrained from commenting upon. This may then allow HBLB to revisit its income budget for 2011 and avoid the catastrophic cuts to expenditure that your Executive team are proposing on the basis of assumptions taken.

## 6 TARGET YIELD

- We appreciate your comments on the target yield. As the GAMs know, we were asked by you, through your Executive, to approach our Case on this basis. As you have said, it is a comprehensive Case on which we continue to rely. We certainly consider our Case, as amplified in considerable further detail at a series of meetings with Deloitte and through the provision of further information to them, is a “business case” on which we rely.
- Also as you say, the Levy is a mechanism. As with any mechanism, it is put in place in order to achieve an output. In this case, the output is a yield – or for planning purposes a “target yield”. The target yield must be reasonable, and we have put forward what we consider to be an output range that is reasonable in all the circumstances. As you know from our case, there are a great many indicators that suggest a much higher range as being reasonable. However, as we said right from the start, we recognise a great many other issues of a wider context which led us to take a conservative view. Included in this are macro-economic factors. The Levy is a mechanism created by statute to be universal, payable by all operators as the mechanism for transferring funds from the business of betting on races to horseracing in a broad sense (Home Office Quinquennial review).
- We note you say you have come to the view that the Levy 50<sup>th</sup> Scheme cannot be “primarily” based on the target yield output. We appreciate your acknowledgement that target yield is one factor on which it shall be based, and would ask that you set out what clear practical criteria it will be based on, “primarily” and otherwise.
- We recognise the complexity of the task at hand. However, that recognition was at the heart of us promoting and agreeing a new process to ensure that these complex issue would be addressed. We undertook considerable work and have continued to do so in order to assist you in carrying out your role. One particular driver was to avoid any possibility of it being said that because the whole exercise, or any one issue within it, were too difficult, that it would therefore be avoided. Avoiding issues has cost Racing many tens of millions, as was made clear in opposition by spokesmen for what is now the Coalition Government. One issue that has cost racing more than any other has been the failure to address and secure the proper contribution from exchange activity, which the previous Determination in 2007/8 acknowledged had not been addressed due to its complexity. As we address below, exchanges are not a matter that can be excluded from consideration in the 50<sup>th</sup> Scheme, which makes a question (if indeed this is being asked) as to what would be a different range without considering exchange activity “unaskable”.
- The complexity of the task is in some ways reflected in the many overlapping and in certain important aspects internally inconsistent themes raised in paragraph 6 of your note. We have had some discussion through the Executive which has assisted to a certain degree. We will seek to respond to the issues you raise, although the way the paragraph has been put together makes this a significant challenge.
- One core purpose behind adopting a target yield is to overcome the fact that neither Racing, nor HBLB, has access to the level of detailed information that would be required to determine, to the appropriate level of rigour, the level and comparative levels of contribution from each business represented on the BC, or indeed the categories of business. The best approach, we believe, therefore has been to identify a target range, and to put that to the BC for them produce a Scheme which has the desired probability of achieving a yield within that range, in doing so resolving

between them the issue of what contribution should be made by each of them and on what basis. We continue to urge that approach.

- We feel that is even more the case bearing in mind the HBLB has itself made a number of assumptions as to what it requires in terms of income for its own internal financial purposes. In these circumstances, and bearing in mind that Racing is concerned with the output to the sport in terms of distributions to achieve the statutory objectives, we would appreciate the HBLB's own indications (respecting that they would be just that, and not binding) as to what would be available for distribution at different levels of Levy yield.
- We note your reference to concepts of "Existing Coverage" and "Existing Contribution" and as these are new and not defined by you in the note, have sought clarification from the Executive. We understand these to refer to those entities who are now paying. There then appears to be a suggestion that "betting exchanges" and "offshore operators" are not in the existing coverage. In relation to exchanges, of course, any platform itself is covered by the Scheme – and it is of the greatest significance that such issue is addressed now. There is a separate issue of the view (which is shared by many in the betting industry) that there are entities who **should** be paying now as a matter of law who are operating through exchanges. We await your conclusions and actions to address this, as we feel sure do the betting operators who agree with us. As to Offshore Operators who under law do not now have an obligation to pay levy – we understand this. However, we would note that it is stated Levy Board policy that they should – we also note the iniquity of groups with a presence in the Great Britain not having to pay Levy and would ask you to clarify how you are dealing with these in your approach of Existing Contributors, and also in relation to capacity to pay. This seems to us to be internally inconsistent on our first reading. William Hill and Ladbrokes as an example are, at group level, enjoying the full benefit from decisions to move parts of their business offshore. We understand that so called offshore operators such as Blue Square, or Sky Bet, and others no doubt, have a corporate presence in the Great Britain and we therefore believe that those businesses are within the scope and should also contribute. The reference to capacity to pay cannot be right in these circumstances and we therefore question the concept that is apparently then followed through to apparently state that Racing should not seek a fair contribution from such betting operators. There is a need for immediate action, as indicated by the recent public statement by Lord Howard on the matter, and who identified a potential solution to the problem.
- We would also ask you therefore to confirm what we understand from your assertions in paragraph 6 that you are saying that the figure of £130m to £150m is not something on which you "would require persuasion" and is not something you would "doubt whether there is capacity to pay" in the event of the Levy achieving full coverage and full contribution.
- The note refers to "prima facie evidence that there has been a decline in gross win on British horse racing". We have not been supplied with any evidence at all in relation to this matter. In any event, we would query what relevance this assertion has to the task at hand and in particular the assertions made in the same sentence in your note. As far as we are concerned, the most significant contributors to "a decline in gross win on British horseracing" are the combined and interrelated impacts on certain betting operator models of a high volume/low margin exchange model, the impact of low margin offshore operations, the incentives to promote machine businesses that operators are translating into focussed in-shop promotion of such business over racing betting, the fact that there is non-leviable racing content from

overseas in shops You have separately received our note in relation to the reversion in whole or in part to a turnover Scheme. Your highlighting the issue makes us conclude that the return to turnover for all or part of the 50<sup>th</sup> Scheme is the appropriate response.

## 7 SPECIFIC COMMENTS ON ANNEX 'A'

In response to your specific question about the Annex, we consider that it is fundamentally flawed as detailed below. We would therefore consider that neither it as a whole nor any of the data in the Annex should be relied upon as part of your Assessment. We would suggest your Executive leads detailed discussion with us, and Deloitte, so that they can explain their assumptions further.

A matter of further concern is the two page article by David Ashforth in the Racing Post of 21<sup>st</sup> October. The table in the Article is, in our view, clearly based in some respects on Annex 'A', and, if this is the case, is a serious breach of Board confidentiality.

- In the Assessment you appear to set great store by the Annex. The Annex is titled 'REVENUES RECEIVED BY RACING FROM **BETTING**'. However, this is not the case. There are lines which are not received from "Betting", which can only be "Betting" as defined in a consistent way with the Statutes (ie those interests represented by the Bookmakers Committee) and in a way consistent with the approach to Existing Scope and Existing Contributors. We fail to see how the statement referring to "total amount provided by betting for racing" in paragraph 6 can possibly marry with the matters referred to in the Annex. Bearing in mind you say that you are "minded to take this into account", and the importance of such a phrase, we feel we have to correct it in detail.
- The relevance to the Levy discussions of many of the lines of data is discussed below, but in any event, any payments to be considered should be those from current Levy payers only. Data in the Annex relating to income from picture rights, sponsorship, international and internet includes payments from non-Levy payers and we would ask the HBLB Executive to revise the Annex to exclude these, and to make clear the assumptions they have made in doing so.
- British Horseracing refutes any linkage between statutory Levy contributions and any commercial payments for rights by Betting (as we define it, those concerns whose interests are represented around the Bookmakers Committee) from interests represented by Racing, save for those commercial payments being included as part of the wide assessment of the betting industry's capacity to pay, which should include all revenue sources of betting operators as well as all their costs; and in consideration of Racing's needs, but only as part of Racing's total income and expenditure from all sources.
- Payments for the right to provide television coverage of racecourses' fixtures in LBOs are under commercial contracts for a specific service. Similarly, they are completely separate from sponsorship payments, which are also for a distinct and definable service.
- The Levy is to be universal, payable by all operators as the mechanism for transferring funds from the business of betting on races to horseracing in a broad sense. In contrast numerous betting platforms – particularly phone, internet and smartphone - and even some LBOs – do not require picture rights in order to conduct betting business. It is not a central part of their offering.

- The Levy should in no way exist to provide a form of relief for commercial deals that are struck for specific reasons.
- It can also be argued that increased payments for picture rights are a result of the ending of a 20-year monopoly owned by betting interests in the sale and purchase of such rights. Only now is a fair market value being realised.
- We suggest that the HBLB Executive consider for the GAMs the question as to why Betting is willing to pay increased sums to Racing for picture rights when, on the face of it, horseracing is less popular. The Bookmakers' Committee has not tackled this. Perhaps it is because
  - Horseracing remains popular in LBOs but the Levy returns are distorted by decline in gross win and/or thresholds; and
  - Horseracing pictures are a key driver for other businesses including FOBTs and hence have a strategic value.
- Further, picture service providers are paying increased sums not just for British but also overseas, notably Irish and South African Racing adding credence to the argument around the strategic value of live pictures. There is real competition in this area for the first time.
- Any direct linkage between the two (or more) income streams brings in a notional cap on commercial activity and an immediate disincentive to innovate.
- The numbers are now in absolute terms incorrect in any event, and therefore misleading, including for instance estimated levy yield numbers. These have subsequently been revised down substantially by your Finance Director and require correction. Irrespective of the numbers themselves, and the validity or otherwise of assumptions used in producing forecast information, financial projections for any period post March 2012 are not and cannot be relevant to discussions for the 50<sup>th</sup> Scheme. Therefore, columns for 2013 and 2014 would have to be deleted from future iterations of this schedule.
- The schedule is incomplete and therefore misleading in that it does not set out information which is necessary for comparison purposes (which we gather to be its intended purpose) such as:
  - Data showing the growth in the fixture list
  - Inflation (both generally or specifically in relation to the rights or categories of rights to which they refer)
- We would query why 2006 been chosen as the start year. This could be taken as misleading in the context of the history of the Levy over the last decade, which requires significant accompanying narrative in order to be meaningful for the purposes of an analysis such as that we are led to believe you are intending to make. We would for instance suggest that a dataset and accompanying narrative should cover 2002 - [March] 2012 i.e. the period post Tessa Jowell's determination of the 41<sup>st</sup> Scheme.
- The HBLB Executive has not been able to provide any source information from which the Annex was created, so we cannot comment upon the accuracy of the numbers presented or their provenance.

- We have produced a detailed schedule of information which is attached to this note. This has been supplied separately to the Department at their request. This includes certain information in relation to Media income. Although this part of our schedule is based on commercially sensitive information, we would be happy to share this data to the Deloitte team so that they can validate our schedule for you.

Specifically, therefore, we would say as follows:

#### **Levy Yield**

- For the avoidance of doubt, it is against this line that Racing makes the case for the reasonable return to Racing to be in the range £130m - £150m.
- We would have expected to see the forecast information presented at the HBLB meeting on 15 September; this could now be replaced by the forecast information presented to the October meeting i.e. a forecast yield for the 49<sup>th</sup> Scheme of only £59.5m.

#### **Revenues from sale of pictures to LBOs**

- Racing does not recognise these numbers and as noted above we have set out our own data in a separate schedule.
- In both your schedule and ours, it should be made clear that the rights being sold are for Irish and British LBOs. We estimate that the licensee's of those rights (SIS and TurfTV) then earn around 10% of their revenues selling picture service to non-Levy paying LBOs in Ireland and Northern Ireland.

#### **Revenues from Tote less picture rights and Levy**

- In the future forecasting, what assumption has been made (and for what reason) regarding the Tote's contribution to Racing in the light of recent Government announcements regarding resolving the future of the Tote? It is perverse that the ability of other betting operators to pay Levy should be in any way influenced by the Tote's voluntary contributions to racing as part of its raison d'être. Equally, it would appear to follow from your assertions in this paper – with which we disagree - that any potential real terms reduction in revenues from the Tote should be equalised by increased contributions from Betting interests. This further supports our view that the approach you have taken is flawed. The same would appear to be the case if broadcast values from the UK market were to fall.

#### **Racecourse revenues for bookmakers' sponsorship, racecourse payments**

- Again, Racing does not recognise these numbers and your Executive has not been able to explain them to us.
- Please could you separate into a different line the sponsorship by non-Levy paying bookmakers.
- How has HBLB accounted for sponsorships by companies that have Levy and non-Levy paying subsidiaries e.g. Ladbrokes plc, particularly in the light of the online (generally non-levy paying) market being the most competitive and therefore the target of the sponsorship activity (and many of the products being advertised are non-racing eg gaming and casino). Again, the element attributable to non-leviable business should be shown separately.



### **Revenues from international, internet sales**

- Again, Racing does not recognise these numbers and your Executive has not been able to explain them to us – either as to what they represent, or how they relate to “Betting”, and how they could be taken into account. We take significant issue with what we consider to be an irrational and flawed approach.

### **‘It is assessed that the actual amount that bookmakers pay for pictures to LBOs is about 3 times the amount received by racecourses.’**

- This is an incorrect and highly prejudicial statement through the use of the term ‘pictures’ given the use of the same phrase elsewhere in the Annex.
- HBLB should state clearly and in much more detail what it is that bookmakers are paying for.
- No source is given for the ‘3 times’ multiplier comment.

## **8 BETTING SHOP CLOSURES**

There is an issue on which the BC has been put to test by the HBLB but as far as we are aware the BC is refusing to alter its position.

Previously, the BC has contended that the impact of the removal of thresholds would be the closure of a significant number of betting shops. We note that the BC Chairman chose not to make that claim in his public comments on 20 October through the Racing Post, instead making a similarly groundless claim that more than 400 shops would close if levy on overseas horseracing was to be reintroduced. Both claims are without justification. It is also notable that they are entirely inconsistent with another of his groundless and persistent claims that British Racing is of decreasing importance to their business. Further, the BC Chairman wrote to you on 30 September claiming that 400 shops would close in the next twelve months based on current commercial viability. Again, these claims were not substantiated, and nor were they in the E&Y supplementary report as his letter of 30 September undertook that it would. We await E and Y putting their name to a report which addresses this issue, and which would for example include all the following issues.

We would note that the BC have failed to set out the reality of “shop numbers” in the context of the issue at hand of “capacity to pay”. As we highlight below, and as is at the heart of what William Hill and others are saying of exchanges, one very significant factor in shop business models and therefore profitability is the disruption to the former shop business model by exchanges, and the significant negative effect on margin. We note the similar impact of offshore operators on shop margin and overall business. We also note in this regard the downstream impact on shop businesses and the incentive it creates for shops to focus on machine business (which is clearly seen from central management instructions to shop managers to concentrate on promoting machine spend as opposed to betting on racing. In this regard, we note the failure of the BC to deliver on the undertakings made in the course of previous Levy Scheme negotiations to increase on a demonstrable basis their promotion of betting on horseracing).

We also highlight the fact, which is totally at odds with the BC Chairman’s unsubstantiated claims that major operators are still looking to expand their estates, with William Hill reporting to investors a target of 70 new licences in 2010 and up to 250 shop refurbishments. We note that there has never been an analysis from the BC of the impact of competition between operators of shop businesses in all the circumstances of the sector, including the continuing trend of consolidation. We have also never seen an explanation as

to how the claims made by the BC sit with the fact that as a direct consequence of wider issues, including Government's own regulatory policy, the costs of operation of small betting operators have increased at a greater proportionate rate than for major operators, and we have not seen any justification as to why any such consequences should be made up by the racing industry through the Levy.

The BC has failed to show in any way also how any shop closures either based on real case based example and analysis or on a hypothetical model would impact on Levy yield, given the totality of the context including substitution.

25<sup>th</sup> October 2010