Betfair comment on submissions to the HBLB Consultation Exercise regarding betting exchanges

In this document the following abbreviations are used:

"ABB" The Association of British Bookmakers.
"Betfair's rebuttal of Racing" Betfair document dated 21 October 2010, rebutting claims made in Racing's submission to the Consultation.
"Betfair's submission" Betfair document dated 20 September 2010, in response to the Consultation.
"BHA" The British Horseracing Authority.
"The Board" The Horserace Betting Levy Board.
"Consultation" The consultation exercise initiated by the Board in July 2010.
"CP" The Betting Exchanges Consultation Paper issued by the Board in July 2010.
"DCMS" Department for Culture, Media and Sport.
"Exchanges" Betting Exchanges.
"FOI Bundle" The documents provided by HM Treasury in response to a Freedom of Information Act request made by Betfair in April 2009, in relation to HM Treasury's 2004-05 review of the tax treatment of betting exchanges and their customers.
"FRB" The Federation of Racecourse Bookmakers Limited.
"GPT" Gross Profits Tax.
"HM Treasury" Her Majesty's Treasury.
"HM Treasury's Review" The review conducted in 2004-05 by HM Treasury into the tax treatment of betting exchanges and their customers.
"Levy" the British Horserace Betting Levy.
"Racing" A combination of the BHA, the Horsemen's Group and the Racecourse Association.
"Racing's submission" Racing's September 2010 submission to the Consultation.
"Sporting Options" R (on the application of Sporting Options) v Horseracing (sic) Betting Levy Board [2003] EWHC 1943 (Admin Hooper J).
"1963 Act" Betting, Gaming and Lotteries Act 1963.

1. Introduction

Having now had an opportunity to consider all of the submissions made to the Consultation, this document seeks to comment in substantive form on three of those submissions.

However, in the interests of timing and to avoid undue repetition of points Betfair has already made to the Board, we have restricted our comments to the most obviously flawed claims within those three submissions. Therefore, a failure to mention any part of those submissions (or any of the other submissions received by the Board) should not be taken as acceptance by Betfair of their contents.

Separately, two annexes are attached to this document. The first contains an assessment of the report prepared by the FRB, which was provided as an attachment to the ABB's submission. This report purports to detail the type of betting exchange activity which can be considered "*business*" use. Betfair contends that the FRB's report is defective from start to finish. The second annex to this document seeks to describe in more detail why the "Levy shortfall" alleged in William Hill's submission is flawed.

2. ABB and FRB submissions

There are consistent themes which appear throughout the ABB and FRB submissions, so it may be helpful to consider these submissions together.

- *The flawed focus on "lay" betting as being distinguishable from "back" betting*

Representatives of traditional bookmaking interests have long argued that from a licensing, tax and Levy perspective, lays bets conducted on an exchange can be distinguished from back bets.[1] The objective behind this claim is obvious, in that most traditional bookmakers do not allow their customers to make lay bets[2] and any such distinction will therefore, in theory, make the singling out of exchange customers less problematic.

The distinction has however been convincingly rejected by DCMS and HM Treasury since as long ago as 2004.[3] Indeed, in an exchange context, several of the Consultation submissions made by individuals point out the folly in seeking to make a distinction between back bets and lay bets.[4]

Not only does the ABB appear to restrict its focus to lay betting, it goes further in para 7 of its submission by claiming that "……*the "layer" [on an exchange] is accepting a contractual obligation to settle and so is the principal in the transaction*." This is factually incorrect. The only party on an exchange with the obligation (or ability) to settle bets, is the exchange operator. Moreover, nothing is provided by the ABB which would lend support to the proposition that an exchange layer can be more correctly labelled as "*principal"* than an exchange backer.

[1] For example, para 2.1 of the William Hill submission which is discussed in more detail at section 3 below, equates laying with bookmaking.
[2] There are exceptions however. For example, see para 5.24 of Betfair's submission.
[3] For example, see para 5.25 of Betfair's submission.
[4] See for example the individual submissions numbered 8, 9, 17 and 18 on the Board's website.

Para 20(c) of the FRB submission claims that any suggestion bookmaking "*is not defined by risk or the action of laying"* would be mistaken, because "*according to s.55 of the 1963 Act, it is*." We find it difficult to understand the basis for asserting that the focus of s.55 is the taking of risk (something done by each party to a bet) or lay betting. Those concepts appear in neither s.55 nor s.27(2)(a).

- *The failure to analyse the most relevant statutory provision*

Both the ABB and FRB assert, without providing any justification, that the first part of the s.55 definition applies to betting exchange customers. The ABB's letter to the Board of 28 May 2010, claimed that "*There can be no doubt that many exchange customers are engaged in the receipt and negotiation of bets*....". The FRB's position here is even more dogmatic.[5]

Referring to the phrase "....*occasionally or regularly*..." within the s.55 definition, in para 17 of the ABB submission it is claimed that "......*frequency of transaction is not, of itself, a test. Rather it is volume which is the better indicator....."*. Whilst we would agree that frequency of transaction is not relevant here, the ABB provides nothing to support the contention that betting volume somehow is relevant to whether someone satisfies the statutory tests for the status of "*bookmaker"*. Betfair suggested in para 4.11 of its rebuttal of Racing's submission, that the use of "*occasionally"* would capture a part-time bookmaker. Furthermore, we believe that this wording within the s.55 definition supports the contention that once it is clear that a person is not conducting any of the activities for which licensing is required,[6] an increase by that person of his betting volume, cannot, at some threshold, convert him from a punter into a bookmaker.

The ABB contends that the imposition by Betfair of non commission-based charges means that it has already undertaken a form of customer categorisation.[7] Betfair considers this to be a red herring and has already addressed to the Board in more detail similar claims made by Racing,[8] but the ABB's position here fails to recognise that its own members routinely categorise and grade their customers.

The ABB and FRB give no consideration to the requirement in s.27(2)(a) of the 1963 Act that to be a leviable bookmaker, a party must be "*effecting"* betting transactions. Para 20(a) of the FRB submission claims: ".....*as it is established that the betting exchange does not enter the transaction at all, the focus must be on the customer as bookmaker*." This could be read as a suggestion that the exchange itself is not a bookmaker. Indeed in para 23 of its submission the FRB states that "*it may be argued that the betting exchange itself is not a leviable bookmaker.....[but] it is leviable in its own right anyway as a betting intermediary under Category 3.1 of the 49th Levy Scheme.*" This claim fails to recognise that if exchanges did not fall under the s.55 definition of "*bookmaker*", the Board would not have the authority to require them to pay Levy. Indeed if it were ever established that the only bookmaking being conducted on a betting exchange was by counterparties to bets, it would be open to Betfair to seek reimbursement from the Board of the £42m plus in Levy payments it has made to date.

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[5] Para 17 of the FRB submission states that "*It is irrefutable that betting exchange customers receive or negotiate bets."*

[6] Holding client funds, settling bets, preventing the platform being used for money laundering etc.

[7] Para 13 of the ABB's submissions claims that "....*such differential treatment, de facto, puts them [relevant exchange customers] in a separate, if undefined, category*."

[8] For example see para 7.20 of Betfair's rebuttal of Racing.

- *The effort to diminish HM Treasury's Review and other investigations which undermine an anti-exchange position*

It is no surprise that the ABB and FRB seek to downplay the relevance of HM Treasury's Review. Para 18 of the ABB's submission claims that "...*the criteria for the assessments associated with each of these taxes [GPT and Levy] are quite different, so drawing this investigation [HM Treasury's Review] into the argument is really something of a smokescreen."* [9] Betfair does not accept this and as we have pointed out to the Board,[10] the definition of "*bookmaker"* for betting duty and Levy purposes, are identical. HM Treasury's Review indirectly determined that even high-volume exchange customers did not meet the s.55 definition of "*bookmaker"*.

In relation to whether tax considerations are relevant to the Consultation, it would appear that the ABB wishes to have its cake and eat it. At paragraph 4 of its submission when discussing the FRB report it attaches as an annex, the ABB states that: "*As will be evident, the report was not written with the Consultation in mind"*, but justifies its inclusion "*because of the light it sheds on this important issue."* It is however apparent from the FRB report that its focus is exclusively on the question of whether exchange customers are bookmakers who should be paying GPT. In other words the ABB is arguing that although GPT is entirely separate to Levy matters, for the purpose of the Consultation the Board should consider an FRB report which claims that exchange customers should be subject to GPT.

Referring to HM Treasury's position that exchange customers are not "*generally able to build in a profit margin to their price"*, para 21 of the ABB submission suggests that this indicates "*....some misunderstanding of the way an exchange market works."* It may be worth pointing out that unlike the author(s) of the ABB submission, HM Treasury spent 20 months analysing the betting activity of the highest volume exchange customers on a bet by bet basis. Betfair would suggest that as a result, the relevant officials are likely to be better informed on the nature of exchange betting than the ABB, or any other respondent to the Consultation.

In defence of its position in para 21, the ABB states that "*it is perfectly possible to lock in a profit....by taking advantage of price movements to create a margin*." In other words, the ABB appears to be suggesting that those exchange customers gambling on price movements are engaging in an activity which can be equated to bookmaking. It is worth pointing out here that any exchange customer gambling on a price movement is still doing so in markets where the over-round hovers around 100%. In any event, HM Treasury examined all types of betting in which exchange customers engage, yet still reached a conclusion that is contrary to the ABB's position here.

In para 32 of its submission, the ABB describes document 9 in the FOI Bundle as having *"no status"* because it is a draft discussion document. This is a notable contrast from the reliance placed by Racing on certain documents within the FOI Bundle. Indeed one of the documents in the FOI Bundle from which Racing's submission quotes most heavily (document 5) is headed "*Discussion paper"*. Betfair believes that the ABB approach here is far more credible than that of Racing. Matters discussed and rejected in the lead up the

[9] In a similar vein, para 6 of the FRB submission states that "*It would be a mistake to conflate taxation and licensing*."

[10] For example see paras 6.5 and 6.12 of Betfair's submission.

conclusion of HM Treasury's Review, are surely less persuasive than had they never been discussed at all.

Para 28 of the ABB submission suggests that at the time the Gambling Bill was going through Parliament, the Government's decided because of the prospective abolition of the Levy in the Horserace Betting and Olympic Lottery Bill, that it "*wasn't worth the trouble"* to bring non-recreational layers within the scope of Levy. Betfair does not believe that the ABB's arguments are persuasive here. In any event, what is clear is that the Government accepted that the only way in which exchange customers could be brought within the Levy, was if the "*current law"* were amended.[11] That law is still in place. Without specific amendment to it, such exchange customers cannot be leviable. No amendments have been proposed by Government. Accordingly, it remains the case that under the 1963 Act, exchange customers are not within the ambit of the Levy.

- *The attempts to knock down "straw men"*

It is not a criticism of the ABB or FRB that they seek to address the "*Possible lines of analysis"* set out in section J of the CP. However, as stated previously,[12] Betfair has serious misgivings about the presentation of these arguments in the CP, as key points have been omitted and irrelevant points have been included. Seeking to knock down poorly constructed arguments does not make the ABB and FRB cases any more compelling.

An example of this is the assertion in para 41 of the ABB's submission that "...*exchanges argued assiduously that they were not bookmakers*...". The failure to provide any evidence for this assertion, other than pointing to the erroneous claim in Hooper J's Sporting Options judgment,[13] is consistent with the ABB's failure to provide evidence more generally in support of its contentions.

3. William Hill submission

William Hill's basis for asserting that some form of action must be taken by the Board against betting exchanges or their customers, is a claimed Levy shortfall "*at least £30m per annum"*, apparently being caused by "*business users"* of exchanges. This claim features prominently in both the executive summary of William Hill's submission and the press release which accompanied the submission's publication. This "*£30m shortfall"* figure has since been cited with approval by the BHA.[14] Perhaps the prominence given to the "winnings" of exchange customers in para 5 of the CP has misled William Hill?[15]

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[11] "*The Government is not persuaded that the current law should be amended to bring exchange users within the scope of the horserace betting levy arrangements."* From page 38 of the Government response of June 2004, to the First Report of the Joint Committee on the Draft Gambling Bill

[12] See para 7.12 of Betfair's submission.

[13] As stated in para 7.6 of Betfair's submission, Hooper J's choice of words suggests that the claim supposedly made by Betfair was not something for which he had seen any satisfactory evidence. Betfair has never "*insisted that it was not a bookmaker*".

[14] For example, see BHA press release of 21 September 2010: "*British Horseracing reacts to Betfair's IPO announcement".*

[15] Para 5 of the CP states: *"It has been said that betting exchanges account for 17% of the British betting market and the net winnings of those betting through exchanges is in the order of £1.5*

Para 1.7 of William Hill's submission seeks to justify this shortfall claim. However, in doing so, it is readily apparent that it has used a metric which even Racing's submission has accepted is deeply flawed.[16] By using an approximation of exchange commission revenues on British horseracing as a starting point, William Hill would appear to have made the fundamental mistake of confusing the gross winnings and net winnings of exchange customers.

Betfair's commission is derived from the winnings of customers on each individual market offered on the exchange. A customer with many winning markets will pay commission on each to Betfair, but the combination of such commission deductions and any number of losing markets, may mean that the customer is a net loser on the exchange. Indeed, as pointed out in para 5.30 of Racing's submission, irrespective of the size of any such gross winnings number, it is possible for the net winnings of exchange customers over a given period, to net out to zero.

William Hill's "shortfall" analysis therefore relies on the use of a number (the gross winnings of exchange customers) which:

(i) has correctly been discredited by Racing's submission;

(ii) is not comparable to the basis on which bookmakers are required to account for Levy;[17] and

(iii) involves a guess by William Hill in relation to what proportion of this misleading number comprises the winnings of exchange customers which (without anything by way of supporting evidence), William Hill claims are "*business users*".

So flawed is the analysis underpinning this claimed shortfall, that Betfair has written to the William Hill Chief Executive to request that substantiation for it be provided. In response, the William Hill Chief Executive provided absolutely no justification for the claim.[18]

An independent reader of William Hill's submission might ask what conclusions could be drawn if that company's own British horseracing business were subjected to the same analysis.[19] In other words, were someone to:

(i) add up the total of all of William Hill's customers winning bets on British horseracing, ignoring all losing bets;

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billion." Para 7.2 of Betfair's submission expresses concern about the misleading nature of para 5 of the CP.

[16] In particular see para 5.34 of Racing's submission. See also para 7.2 of Betfair's submission and paras 7.16 and 7.17 of Betfair's rebuttal of Racing.

[17] Although Levy is based on operator "gross profits", the number on which it is charged to bookmakers is their net winnings over the Levy year (before expenses). William Hill's workings suggest that an undefined class of exchange customers should be paying Levy on their profits from each winning market, without allowing for such winnings to be offset against losing markets.

[18] Correspondence between Betfair and William Hill in this respect is available to the Board on request.

[19] See Annex 2 to this paper for some further analysis on this.

(ii) assume that 10% of this amount is won by "business" customers, as William Hill has done in relation to Betfair's customer base; and

(iii) deduce that the amount represented by 10% of these winning bets is the amount by which "business" customers of William Hill are shortchanging the Levy.

In the absence of any other evidence, it would be absurd to suggest that this alone provided any indication that many of William Hill's customers were "*in business"*, or that William Hill was enabling them to avoid any amount of Levy, yet that is precisely the method used in William Hill's submission to reach its conclusions about Betfair. The Board cannot reasonably rely on such an obviously flawed calculation.

- *Other flaws in William Hill's submission*

Notwithstanding the basis underpinning William Hill's submission being so demonstrably misconceived, we would like to point out some of the other clear defects it contains as follows:

William Hill makes no attempt to analyse the statutory definition of "*bookmaker"*. Indeed its submission recognises that the Consultation represents an attempt to "*shoehorn betting exchanges into existing statutory provisions"*.

Consistent with the submissions of Racing, the ABB and the FRB, William Hill makes assertions about "*business users"* of exchanges which are based on anecdote and supposition.[20] William Hill claims that "*.....more and more currently regulated independent bookmakers will look at their cost base and feel that they could run a viable business laying prices on the exchanges rather than betting premises."* In other words, with no supporting evidence, William Hill is claiming that licensed bookmakers will give up the ability to build a margin into their prices and pick and choose against whom they are prepared to bet, to instead bet against counterparties whose identity they do not know and whose bets they cannot restrict, in markets where the over-round hovers at around 100%.

In relation to what Betfair (and several other respondents to the Consultation) believes to be a discriminatory exercise, the only distinction William Hill is able to provide between "*professional gamblers*" who are outside the tax/Levy net and "*business users"* of betting exchanges (who William Hill claim should be subject to Levy), is that the latter "*have the capacity to use the exchange to both back and lay on events to lock in a profit*." This suggests that consistently profitable exchange customers taking outright positions (i.e. not looking to "*lock in a profit"* on a bet) are by William Hill's definition, equivalent to "*professional gamblers"* who are outside the tax/Levy net.

Para 1.12 of William Hill's submission claims that not only is betting exchange use the cause of the "*majority of horseracing integrity issues"*, but that exchanges do not pay a fair proportion of integrity costs compared with traditional bookmakers. However, Betfair's approach to sharing information with those tasked with keeping corruption out of British horseracing is in stark contrast with William Hill's well-documented historical reluctance in this area. Moreover, in addition to Betfair's Levy contribution, it has invested significantly to provide an 8 person full time Integrity team, which provides

[20] For example, the executive summary of William Hill's submission states: "*There are without doubt betting exchange business users who are actively engaged in levy avoidance*...".

complete cooperation with the sport's regulator. Further, Betfair has, at its own cost, developed bespoke software which enables BHA's analysts to view individual (but anonymised) bets being placed on the exchange in "real time".

With its call for a "*full review of the betting exchange business model by the authorities which should include independent scrutiny of the type of customer using the exchanges...*", it would seem that William Hill is deliberately ignoring the numerous investigations and reviews since 2002 to date. Alternatively, it seems that William Hill accepts that the current legislation cannot impose discriminatory obligations on exchange customers without parliamentary intervention.

Finally, we note that William Hill's submission (in its executive summary) endorses the ABB's submission. Given that the latter document (see page 23 of the FRB report attached to the ABB's submission) calls for non-UK licensed betting operators to be subject to UK tax, we query whether William Hill has actually read the ABB's submission.

4. Other submissions

A recurring theme which emerges from several of the submissions made by individuals is one of surprise that the use of exchanges is being considered by the Board in isolation.[21] The Board will be aware that this is consistent with concerns expressed to it by Betfair, in correspondence in advance of the Consultation's launch,[22] as well as in Betfair's submission and Betfair's rebuttal of Racing.[23]

Another point made by several respondents is that the ability to "make a book" with the exchange over-round hovering around 100% is to all intents and purposes impossible.[24] This tallies with evidence of which the Board is in possession.[25]

The suggestion in submission number 1 (as listed on the Board's website) seems to be that a turnover-based Levy should be introduced, but only for online operators (including exchanges). The suggestion that this would yield £60m annually from Betfair alone (based on the current volume of bets made on the exchange) is as illogical as suggesting that if all retailers doubled their prices overnight, they would double their profits.

5. Conclusions

Betfair's concerns about many aspects of the Consultation are well-known to the Board. We note that if, as claimed by Racing, there are 6,375 "*bookmakers"* on Betfair alone, who are not, but should be, accounting for Levy under current law,[26] the dearth of Consultation responses would suggest that the Board may have reached only a tiny fraction (if any) of potentially impacted people.

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[21] For example see the submissions numbered 5, 9 and 11.

[22] See for example a letter to the Board's Chief Executive dated 8 June 2010, from Martin Cruddace of Betfair.

[23] See for example para 8.3 of Betfair's submission and section 9 of Betfair's rebuttal of Racing.

[24] For example, see the submissions numbered 8, 9 and 17.

[25] In his letter of 2 October 2008 to DCMS, the Board's Chief Executive stated that: "*Licensed bookmakers laying on betting exchanges already pay Levy, although minimal amounts because losses and gains tend to cancel themselves out."*

[26] See para 5.25 of Racing's submission.

Also notable is Racing's ultimate conclusion, that all exchange customers winning on British horseracing should be leviable.[27] Conveniently, this would achieve Racing's primary objective: irrespective of whether it was fair, lawful or reasonable, it would raise, so Racing believes, the maximum possible revenue for the sport.

It is not merely Betfair's opinion that William's Hill "£30m shortfall" claim is entirely bogus. The flaws in the claim have been clearly demonstrated above. The deconstruction of William Hill's claim is directly supported by Racing's submission. That fictitious claim aside, the submissions by competitors of exchanges all argue for something which they believe would cause maximum commercial damage to exchanges, without in any way impinging on those competitors' own activities or those of their customers. Hence the clear focus in the submissions of the ABB, the FRB and William Hill, on exchange customers who make lay bets, something not generally available to customers of traditional bookmakers, or anyone gambling on price movements on exchanges, which some parties refer to as "*trading*". The claim by traditional bookmaking interests that it is these activities, as carried out by exchange customers, which should attract tax, licensing and Levy obligations not borne by customers of traditional bookmakers, is transparently self-serving.

The inconsistency among interests adverse to exchanges on the question of whether the current law allows for a class of exchange customers to be leviable, is telling. For example, William Hill's executive summary claims that the Government "*made the decision to leave business users of exchanges outside the scope of tax and levy*…." and "*there is undoubtedly the need for a wider review and possible legislative change*." However, William Hill also claims that this "*should not hold up HBLB, which working within existing levy legislation could move to identify and levy business users of exchanges.*" So, according to William Hill, the Government took a decision to leave exchange customers out of the scope of Levy and therefore to bring them within it, a change of law is required. In the meantime however, the Board should somehow (using the current inadequate law) enforce the Levy – a tax – against this undefined group of exchange customers.

Betfair submits that in reality the anti-exchange alliance between Racing and some elements within the betting industry, recognises what all of the independent investigations since 2002 to date have confirmed, namely that there is nothing within the law as it stands from a tax, Levy or licensing perspective which can justify the singling out the use of exchanges and the imposition of discriminatory obligations on their customers.

Betfair, 8 November 2010.

[27] See para 7.2 of Racing's submission.

Annex 1

The majority of the ABB's submission comprises an FRB report "*on the changing world of trading on betting exchanges 2004-2010"*, which is attached as Annex A to its submission.

In common with Racing's submission, this report purports to provide evidence of activity by individuals whom it believes should be subject to taxation and Levy, but then proceeds to make numerous assertions with no attempt to substantiate them and provides no evidence of the activity it claims is so prevalent.

The report concludes that there is a category of exchange customers who should be singled out for licensing and taxation, but its conclusions are inconsistent with the points argued by Racing in its submission. Where Racing has claimed that all exchange customers who win, whether backing or laying, are leviable bookmakers under existing legislation, the FRB's report concludes that only lay bets are to be considered and that new legislation is necessary to address the matter. The exchange customers on whom the FRB's report focuses are "*non-recreational layers"*, a categorisation that was rejected by Government as long ago as 2004.

In contrast to Racing's submission, the FRB's report has understood a major hurdle it must overcome: namely to explain why the situation has changed since HM Treasury's Review. However, despite its ambitious claims, the report fails to do this.

In summary the report is deficient for the following reasons:

- The report is replete with unsubstantiated assertions. It frequently concedes that it has no evidence to support many of the claims therein, openly admitting that those claims made are simply uninformed speculation.

- The report discusses at length two organisations, purporting to shed light on "business use" of exchanges by unlicensed bookmakers. However both organisations discussed, Betting Promotion and Betfair Malta, are Maltese licensed betting operators, taxed in accordance with Maltese law.

- The report states that a betting operator trading under a non-UK licence should be subject to UK taxation. It also states that exchanges should be forced to reveal the identity of any customers either holding an account balance over an unspecified threshold, or who are subject to terms that differ from the standard terms applicable to exchange customers in general. This would suggest that the report is calling for legislative changes to make this possible, as the Board currently has no power to require such information. Any such legislation would surely have to apply to all betting operators. We question whether certain ABB members really endorse a report demanding that non-UK licensed betting operators be subject to UK tax; and that they reveal confidential details on their customers together with the details of any non-standard customer accounts (arrangements they may have for trainers or journalists for example).

- The report claims that setting appropriate thresholds would be simple, yet fails to provide even a suggestion as to what those appropriate thresholds might be.
- The report equates the automation of betting (albeit only on exchanges) with bookmaking, with no justification provided for this position.
- The report proposes a number of flawed schemes by which discriminatory tax and Levy charges could be applied to gamblers, but only gamblers using exchanges.

More specifically, Betfair would like to draw the Board's attention to the following elements of the report.

1. Page 17 notes that the number of Betfair customers has increased from 2 million to 3 million since 2008. It states that "*The 50% increase is almost certainly correspondent to the growth of automated betting"*. No evidence is provided to support this claim.

   Other online gaming firms have grown significantly too in recent years. To choose just one example, Bet365 claims it has more than 4 million online customers in 200 countries.

2. Pages 18 and 19 demonstrate a complete failure by the FRB to understand the reasons why the Government rejected a proposal to single out a category of exchange customer (the "non-recreational layer") during the drafting of the 2005 Act. The FRB appears to have concluded that the Government rejected this proposal because of an unspecified difficulty in determining a particular customer's profit or loss with a particular betting exchange operator. The Government's stated reasons for rejecting the concept of "non-recreational layers" were:[28]

   - That any distinction between backing and laying would be arbitrary; and
   - The difficulty in determining an appropriate threshold, above which it could be safely concluded a customer's activity was "non-recreational".

3. Page 19 contains an assertion that there has been a rapid growth of "*businesses*" and *"partnerships*" acting as "*layers and/or seeders*" during the period, followed by the assertion that "*For the avoidance of doubt there has been a dramatic revolution in the past six years with relation to the professionalisation of operative trading on exchanges most particularly on Betfair and Betdaq*." No evidence whatsoever is provided by the FRB to substantiate the claim.

4. Page 20 alleges that it is far more likely that an individual customer of Betfair will be betting against a "*business*", than another individual. The FRB provides no evidence to substantiate this claim. Page 20 also alleges that the concept of people betting against each other is no longer true, but again without providing any evidence to substantiate that assertion.

5. Page 20 further claims that betting exchange markets are "*virtually controlled"* by "*businesses*" at all times. The reality is that the only "*control*" that any customer of an

[28] See para 107 of the Government response of June 2004, to the First Report of the Joint Committee on the Draft Gambling Bill.

exchange can exert on a market is to put up bet offers that they are willing to match. Having done so there is nothing whatsoever that that customer can do, to prevent another customer going ahead of them in the queue by offering a better price. On this point the FRB displays a lack of understanding of how exchange markets work.

6. The same paragraph in the report alleges that "*there are clear indicators to suggest that the betting exchange operators themselves are directly involved in the process as layers*". What these "*clear indicators*" are, the FRB declines to say.

7. In any event it is unclear what point the FRB is trying to make here. If a UK exchange operator holds only a betting intermediary licence, then that operator would be committing a licensing offence by undertaking activity requiring a general betting operator's licence. If on the other hand the exchange operator also holds a general betting operating licence, then the activity alleged would be precisely that envisaged and provided for by the operator's licence. The FRB is either alleging that one or more betting exchange operators (it neglects to say which) is committing a licensing offence but without any evidence to support such a claim, or it is alleging that a general betting operator is operating as a general betting operator.

8. Page 21 alleges that the first bet placed into a newly opened exchange market is "*invariably initiated by a professional market maker"*. No evidence is provided to substantiate this claim. Any customer can place the first bet in a newly opened market, stating the price at which they are prepared to bet.

9. Page 21 also alleges that a "*close inspection"* of markets shows that they are rarely influenced by individual punters but are under the control of "*co-operatives and organisations"*, none of whom it chooses to identify. The FRB makes no attempt to explain how such supposed "*close inspection"* can reveal such control by co-operatives or organisations, whether by reference to any worked example or otherwise. Again, no data or evidence, nor any analysis, is provided to substantiate the claim.

10. Page 21 refers to the activities of Mr. Kevin Griffiths, the disgraced former managing director of failed betting exchange Sporting Options. As was clear over 6 years ago, Mr. Griffith's activities were plainly not in accordance with his company's terms and conditions or any description given to customers of what they could expect if betting with his company. Citing Sporting Options as representative of the operation of exchanges generally, is as unreasonable as citing Burns Brothers, Luvbet, or any other bookmaker which has ever collapsed with a hole in client funds, as representative of how traditional bookmakers run their businesses.

11. Page 21 also asserts that anyone wanting to operate as a "*market* maker" would need a large number of personnel working for them. This would appear to significantly undermine the FRB and ABB's position, as if the supposedly licensable/leviable/taxable activity in question requires "*by necessity"* a large number of personnel, this would suggest that any exchange customers who bet as individuals, by definition have a status which is different to the "*business"* users on which the FRB focuses.

12. Page 22 acknowledges that claims that exchange operators provide "*seeders"* with "*drastically favourable"* commission rates are "*unsubstantiated"*, or in other words the FRB has no evidence of this happening. The same page of the report then makes claims that it admits are "*equally unproven"*, despite being "*often repeated"*.

13. The remainder of Page 22 and Page 23 are taken up with a series of points regarding Betting Promotion, a Swedish company which provides pricing and risk management services to exchanges and to traditional bookmakers, via a Maltese licensed company. As an aside, we suspect that the FRB may have misinterpreted Betting Promotion's CEO comment that "*the betting exchange market is now dominated by a few large companies"*. The large companies being referred to are in fact exchange operators such as Betfair.

14. Betting Promotion's website (www.bettingpromotion.se) provides full transparency about the company and its activities. From reading its most recent report, hyper-linked prominently from Betting Promotion's homepage, it is apparent that it bets on football and "*a number of different sports, e.g. tennis, ice hockey, rugby, basketball and American football."*

15. In relation to the Consultation, the following points in relation to Betting Promotion will therefore be relevant:

    - it is a licensed betting operator;
    - it is not based in the UK;
    - it does not bet with Betfair in the UK (Betfair Ltd does not accept bets from non-UK customers or operators, with the exception of Betfair International); and
    - it does not appear to bet on British horseracing.

16. To be clear, we have never seen anyone claim that Betting Promotion is anything other than a licensed betting operator. However as it is not based in the UK, it is not subject to GPT or Levy, in the same way that the online operations of bookmakers such as William Hill and Ladbrokes are subject to neither.

17. The final assertion of page 23, underlined in the report for effect, is remarkable: "*Without doubt this company is clearly not a recreational user and should be liable for taxation purposes in the UK".* It is surprising to Betfair that the ABB and William Hill have endorsed a report which asserts that non-UK betting operators should be liable for taxation (and presumably Levy) in the UK.

18. Page 24 claims that "*reputedly"* companies were used by Betfair to create liquidity in fringe markets such as basketball and ice hockey. However, the FRB does not claim that the alleged activity was being conducted by parties not holding applicable operator licenses and neither sport mentioned is British horseracing. It is difficult therefore to understand the relevance of this to the Consultation.

19. Page 24 alleges that incentivisation for "*market makers"* would need to be considerable, with no evidence provided to substantiate that assertion. In fact the scant evidence the FRB does have regarding "*market makers"* contradicts this assertion completely. The interim Q2 2010 report of Betting Promotion, the subject of the FRB's speculation on pages 22 and 23 of its report, is publicly available on the homepage of Betting Promotion's website. This reveals that rather than being paid by exchanges, in Q2 of 2010 alone, Betting Promotion paid SEK 4.2 million of fees to exchanges.

20. The FRB then concludes that these payments from exchanges to market makers, for which it has no evidence, may well be "*direct"* payments. Once again, no evidence is provided to substantiate that assertion, however it does at this point admit that any opinion it expresses on the topic "*can only be the subject of speculation".*

21. The report then moves to how Betfair hedges risk on its multiples product, with the claim that such hedging is done: "*to the financial advantage of Betfair beyond their role as betting exchange operator".* This betrays a misunderstanding of how Betfair's multiples product is managed.

22. Betfair takes multiples bets as principal, via an entity licensed and regulated to do so. This point is acknowledged by the FRB on page 25. Betfair's hedging team will seek to hedge the legs of cumulative multiples bets by betting into the relevant exchange markets. Genuine hedging activity such as this (transactions placed to reduce a position, rather than to move a price) is unsurprisingly a cost to Betfair. However this is a cost Betfair is prepared to incur for the benefit of reduced exposure to adverse results. The FRB's assertion that this activity is conducted to the financial advantage of Betfair is therefore misguided.

23. Page 25 declares in bold font that "***This would appear to be yet another example of a fully functioning business operation laying on a betting exchange."*** Ignoring the fact that most hedging activity conducted by Betfair's hedging team will take the form of back bets, this represents the FRB's second example of a licensed betting operator transacting with an exchange. It has always been Betfair's stance that licensed operators who use exchanges should account for that activity in accordance with the tax regimes applicable to them, but we fail to see how examples of licensed operators using exchanges has anything to do with those who are not licensed betting operators.

24. Page 25 also asserts that Betfair hedges "*into its own Multiples market"*. This is incorrect. Betfair hedges by converting its exposure on multiples taken, into their constituent single components. Betfair therefore hedges in its singles markets.

25. On page 25 the FRB acknowledges that Betfair has stated that it does not have access to any functionality advantages when hedging, yet on the same page it is claimed that (again, in relation to this hedging activity), "*Betfair would have functionality advantages"*. This latter claim is contradicted on page 26 where the report states that Betfair would no doubt operate within functionality available to others. For the avoidance of doubt, the Betfair hedging team do not use bet placement software which is not available to other Betfair customers.

26. The FRB's suggestion on Page 25 that Betfair's hedging team can place bets in in-running markets without being subject to the bet placement delay imposed on customers, is completely untrue and defamatory.

27. Page 25 also refers to "cross matching" but then provides a totally inaccurate explanation of that functionality. "Cross matching" is part of the Betfair bet matching engine which matches opposing customer bets. It matches a customer bet request against bets on other selections in the same market, if doing so would result in the customer getting a better price than that available just from opposing bets on the same selection. It does not, as the report incorrectly claims, match bets across different markets.

28. Page 26 claims that Betfair customers would be shocked that multiples bets are struck directly with Betfair and that Betfair hedges multiples risk into the exchange markets. Again, it is not clear how this could possibly be relevant to the Consultation, but for the record the first provision in Betfair's publicly available multiples terms and conditions, states that "*When you make a bet, you are betting with Betfair and not with other customers who use our site*". Separately, the "Help" section of Betfair's website contains a question on multiples betting as follows: "*Who takes the other side of my bet?"*, which is answered: "*Multiple bets are struck directly with Betfair."*

29. This section of the report concludes by declaring that "*confirmation from Betfair detailing the exact relationship with the Maltese trading company and the latter's operational activity would be a minimum requirement"*. A "*minimum requirement"* for what, or to whom this should be confirmed, the report does not say.

30. Page 27 poses the question "*how many other businesses are acting as layers on Betfair and the other exchanges?"* Para 4 of the ABB's submission suggested that this report would answer that question and provide evidence. As the report has provided no such evidence, with the exception of discussion of two licensed betting operators, it would appear the FRB is unable to provide any such evidence or answer the question posed here.

31. Page 27 suggests that "*These claims are naturally strongly denied by the exchange operators"*. If the FRB is referring to claims that licensed betting operators bet with exchanges, then Betfair has never seen any such denial from an exchange operator.

32. Page 27 concludes by demanding that exchange operators should reveal information about the account balances (presumably above some unspecified threshold) and commercial terms under which customers transact. Clearly any operator is currently prevented by law from revealing customer information, so presumably the FRB is calling for a change in legislation to provide for that level of transparency. Any such legislation would naturally apply to all betting operators, not just exchanges and would presumably require traditional bookmakers to also reveal the account balances of customers over that threshold, together with details of customers betting on non-standard terms.

33. Page 28 states that: "*Transparency on these issues is key to the successful introduction of a registration process of non-recreational layers and the identification and*

categorisation of these users for taxation purposes." Put another way, it seems that the FRB has no evidence that would justify the introduction of a new category of exchange customers who should be subject to tax/Levy, but it would like exchange operators to open their books (again) so it can try to build a case which HM Treasury (with full access to relevant data), rejected.

34. The FRB makes a number of confused and contradictory points in its discussion of "*Automated Betting"* between pages 29 and 38. For example, on page 30, it is claimed that automation is "*cheap*" and "*easily accessible to all users*". That being the case, it is difficult to see how it could possibly be an indicator of business use.

35. On page 31 the FRB incorrectly states that identification of anyone using automation is simple, because, so it claims, all automated software accesses exchanges via the relevant exchange's API. This betrays a fundamental lack of understanding of the subject matter. An API merely provides a consistent method for accessing a website, but there is nothing forcing a customer to access Betfair, or any other website, programmatically via that channel. There are currently and always have been, customers who prefer to "screen scrape". In other words, to automate their activity by accessing the regular website.

36. Additionally, all manner of software applications will access the exchange through the exchange's API, even though customers placing bets via the relevant channel are not betting programmatically. For example, Betfair customers betting into the exchange via software downloaded onto their mobile phones, are betting through the Betfair API.

37. Any policy which sought to discriminate against any customer automating their activity via an exchange API would result in mass migration to "screen scraping" automation. The providers of the most popular "off the shelf" automation software for Betfair, for example, already include a non-API mode, allowing customers to switch, in rare instances when the API is unavailable.

38. Page 32 highlights that there are plenty of non-transactional uses for software automation. Customers who use automation quite obviously cannot be claimed to be betting "*in business"* if that automation does not involve the placing of bets. This highlights the absurdity of equating the use of automation with being "*in business".*

39. Page 33 discusses a possible application of an automated bet placement strategy, although it neglects to say that automating a betting strategy offers no guarantee that the strategy will be profitable.

40. We also note the declaration on Page 33 that any customer engaging in "arbing", immediately triggers a status change from "*casual layer*" to "*professional arber"*. No logic is provided by the FRB for making this leap.

41. Page 34 alleges that "*more and more"* exchange customers now have a "*non-recreational"* income, but provides no evidence to substantiate this claim.

42. Page 34 discusses at length the merits of Bet Angel's "Soccer Mystic" and "Tennis Trader". Clearly, neither could have any bearing on matters relating to the Levy.

43. Page 35 moves on to discussion of so-called "*trading rooms*". Consistent with the rest of the report there are repeated references here to "*layers*" and "*laying"*, without any explanation of why trading room activity is apparently limited to exchange lay betting.

44. Pages 36 to 38 review software provided by Bet Angel. A number of unsubstantiated claims are made, including that anyone using software automatically becomes a "*professional".* The FRB also seems to place reliance on Bet Angel functionality such as that described as "*Being the Bookmaker"*. As the Board will be aware, some traditional bookmakers have previously described their customer offerings in similar terms.[29]

45. Section 4 of the document on pages 39 and 40 reviews "*key factors".* Firstly this involves the suggestion that a person's betting can be defined as either "*recreational"* or "*non-recreational".* No threshold is offered as providing a basis for making this distinction.

46. There is also a suggestion that the identification of "*non-recreational layers*" is a "*simple*" process which could be triggered by a variety of apparently unconnected factors as follows:

    (i) All those using automated software. However, note that:

        - We have already identified that not all betting conducted via Betfair's API is automated betting.
        - All automated betting on Betfair is not conducted through the API.

    (ii) All those placing in excess of a certain number of lay bets. However, again note that:

        - The FRB does not provide this number.
        - The significance of lay bets only is not explained, notwithstanding the contrary views of DCMS and HM Treasury on the matter.
        - The FRB does not explain what it believes should happen if a customer only exceeds the limit (which it hasn't specified) in one week. Does that customer continue to be "non-recreational", or do they revert to being "recreational"?

    (iii) All customers who pay the Premium Charge, which the FRB claims clearly indicates a "non-recreational" layer.

        - No aspect of the Premium Charge relates to laying, so the FRB's point is plainly incorrect. It is possible to incur the charge without ever placing a lay bet.
        - The FRB does not explain what happens if a customer only incurs the Premium Charge in one week. Does that customer revert to being "*non-recreational"* if they fail to incur the charge in future weeks?

[29] See para 5.24 of Betfair's submission.

- The FRB correctly notes that other exchange operators do not have an equivalent charge, making this practically unworkable as a means of identification.

In short, the "*simple*" registration process described by the FRB is unworkable and illogical.

47. Section 5 ("*Methodology")* then proceeds to discuss possible tax/Levy schemes which could apply to exchange customers meeting the relevant criteria and exceeding the appropriate thresholds, though again those thresholds are not described.

48. Suggestion 1 of section 5 on page 41 of the report sets out an unworkable and impractical scheme based on thresholds which the FRB acknowledges at the top of page 42 would depend entirely on the vigilance of the exchange operator to police. The suggestion also notes that without the settlement of the "fair" number of transactions, a number that will inevitably be arbitrary, the suggestion is unworkable.

49. Suggestion 2 attempts to define a bookmaker based on profit, but then instantly explains the reasons why that approach would be catastrophically flawed because:

    - the level of profitability would be entirely subjective; and

    - "..*it would apply to the infrequent but high staking layer who is <u>not</u> a recreational layer"*. This is a surprising point as presumably people who are not recreational layers are the people the FRB thinks should pay.

50. Suggestion 3 is that the categorisation of exchange customers be based on the commission rate applicable to each customer's exchange account. Any account with a commission rate discounted from the top rate of commission (5% in the case of Betfair) would be taxed on the difference between that top rate and the actual rate applicable to the account, on any winning markets. This is even more flawed than the suggestions described directly above, because:

    - As the FRB admits, such a scheme would make no reference to whether a customer's betting was profitable or not. In other words, a customer who was a net loser in the long-term would be categorised as a bookmaker and taxed/levied as such, while a profitable customer not entitled to a discounted commission rate would be unaffected.

    - It would by definition be discriminatory, because it would apply to betting exchange customers, but not customers of traditional bookmakers placing exactly the same bets.

    - If implemented, there would be no incentive for an exchange operator to offer a discount to the base rate of commission (because none of it would go to the customer). The discount rates offered by operators would effectively become the rates of tax they would volunteer to pay and there would be no incentive for them to set that rate to anything other than zero. Operators would presumably then incentivise customers via other mechanisms. Consequently, it is unlikely that any such tax would raise even a single penny.

51. Notwithstanding the obvious flaws apparent within each of the FRB's suggestions described above, it would appear that in any event they are not options open to the Board, as each would require a change to the current law.

Annex 2

The Board needs to consider carefully whether the logic and assumptions used by William Hill in reaching the "£30m shortfall" number have any validity whatsoever. It is instructive, in this regard, to consider the likely results were the Board to apply exactly the same method and logic to the business of William Hill, as William Hill proposes it apply to Betfair. The method used by William Hill in its submission is:

1. Determine the gross winnings of all customers of the operator. Do not include or consider in the analysis customers' losing bets;

2. Assume 10% of those gross winnings are the net winnings of "business" users; and

3. Claim that there is a Levy shortfall being caused by the failure to collect Levy on the amount produced by point 2 directly above.

The respective numbers William Hill assumes for betting exchanges are:

1. £3bn;

2. £300m; and

3. £30m, the number in the conclusion of William Hill's submission that has been repeated and adopted by the BHA.

William Hill's most recent full-year results, for calendar 2009, show that its online sports betting business, including British horseracing, took customer stakes of £701m and retained £41.8m of revenue from those stakes. Online customers therefore had gross winnings of approximately £660m, the difference between the amount staked, and the amount William Hill retained.

William Hill's annual gross win on sports betting in betting shops was £459.1m, on stakes of £2.6bn, meaning that shop customers had gross winnings (again, not considering any of their losses), of about £2.14bn.[30]

Performing exactly the same analysis on William Hill's retail and online numbers, as William Hill's submission does with Betfair, provides the following results:

1. Customer gross winnings (online and retail) of £2.8bn (£660m online, £2.14bn retail);

2. Assume 10% of those gross winnings are the net winnings of "business" customers, so £280m; and

3. Assume that Levy has been avoided to the tune of 10% of that amount, so £28m.

[30] The source for these figures is William Hill's investor presentation following its recent results announcement, which can be found at the following link: http://www.williamhillplc.com/wmh/investors/results_reports_and_presentation/2010rrp/2010-02-26/2010-02-26.pdf

Of course, this analysis assumes that 100% of sports betting with William Hill in 2009 was on British horseracing. The final "Levy shortfall" will need to be scaled back appropriately, depending on British horseracing's relative share of William Hill's customer winnings. For example, if 30% of William Hill's business is British horseracing, then that would mean "business" users of William Hill are the cause of an annual Levy shortfall of approximately £8.4m.

The Board could ask William Hill a simple question: *is it reasonable to assume that for a betting operator, 10% of all customers' gross winnings (not considering or including their losses) is a sensible estimate for the net profits of "business" customers*?[31]

If the answer is yes, then according to William Hill's own analysis, William Hill and/or its customers are responsible for a Levy shortfall of many millions each year. If the answer is no, then we would suggest that the Board has no option but to reject William Hill's claims relating to Betfair.

[31] It is notable that in response to a Consultation which asks for evidence of "business use" on exchanges, aside from Betfair's submission, only one unlicensed individual who it is suggested might be betting "in business" is named in any of the submissions received by the Board. The individual in question (named in submission 11) is Patrick Veitch, a punter who apparently bets primarily with traditional bookmakers like William Hill and whose well documented betting successes on British horseracing are claimed to have yielded over £10m of (net) profit in recent years.