



**DETERMINATION OF THE  
47<sup>TH</sup> HORSERACE BETTING LEVY SCHEME**

**SUBMISSION OF BRITISH HORSERACING**

26<sup>TH</sup> November 2007



## **INTRODUCTION**

1. The British Horseracing Authority ("Authority") makes this submission on behalf of all constituent members of the sport. We thank the Secretary of State for his consideration of our submission in relation to his determination of the 47<sup>th</sup> Scheme ("Scheme").
2. Despite our best efforts to seek a resolution, the stance of the Bookmakers' Committee has meant that statutory Determination of the next Levy Scheme is now required.
3. For the reasons cited below, the Determination must be broad in scope. The decision of the next Scheme is at the discretion of the Secretary of State. In setting it, it will be necessary for him to make an informed decision which takes proper account of all the circumstances. This is a complex task, and we seek in our submission to make a robust and reasoned case as to what is the appropriate return to British Horseracing.
4. This submission is structured as follows:
  - Section 1: The social, cultural and economic importance of the sport to Britain.
  - Section 2: The basis for Determination of the Levy and its role and legal framework. We examine the factors that must be taken into account by the Secretary of State in determining the proper amount payable under the Scheme. We establish that the return has to be "fair and reasonable". We propose two methodologies for determining the appropriate amount of the Levy. The first (Methodology 1) will use the 41st Levy Determination as its starting point, and analyse the developments in racing's needs, developments in the betting industry and what issues should properly be considered when assessing the bookmakers' "capacity to pay". The second (Methodology 2) will adopt a market-based approach to identify a reasonable return to racing based on a hypothetical negotiation between racing and betting operators that mirrors the key features of the Levy. Methodology 2 is intended to test and validate the reasonableness of the outcome of our calculation pursuant to Methodology 1.
  - Section 3: Sets out our application of Methodology 1.
  - Section 4: Sets out our application of Methodology 2.
  - Section 5: Sets out our proposals for the content of the Scheme and our recommendations moving forwards.

## **1 THE IMPORTANCE OF BRITISH HORSERACING**

**Summary: Racing is a deeply engrained and important part of Britain's sporting and cultural life. Racing also makes a strong contribution to the economy and society as a whole.**

1.1 Racing is a public good: As recognised in Parliamentary debate in Westminster Hall as recently as 21 November, British racing is important to Britain's culture, heritage and international reputation. Britain is internationally recognised as a world leader in the sport of racing, bringing all the benefits associated with sport. The sport clearly contributes to the public interest: it is important to the economy and creates cultural and social benefits. Horseracing promotes objectives of common interest: growth, employment, social cohesion and the environment.

1.2 Economic impact in general terms: By way of illustration:

- Racing generated expenditure of £2856 million in 2005;
- Racing made a tax contribution of £282 million in 2004/05; and
- Capital expenditure for the four years to 2005 totalled £421 million of which £341 million was accounted for by racecourses, and a further £60 million by trainers<sup>1</sup>.

1.3 Tourism: Racing makes a substantial contribution to tourism. Major meetings such as the Cheltenham Festival and the Grand National meeting attract a significant number of domestic and overseas visitors.

By way of illustration:

- In the context of the Grand National at Aintree, 14% of visitors were from Ireland and a further 1.2% from outside the British Isles<sup>2</sup>.

1.4 Local Economies: Racecourse developments are a significant contributor to local economies, not only in providing jobs but also in generating local investment.

By way of illustration:

- Racing is Britain's biggest sport employer being directly responsible for 18,800 full-time equivalent jobs. In addition, 88,300 full time equivalent jobs are supported by racing. These jobs are largely in the low pay sectors, and in rural communities<sup>3</sup>.

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<sup>1</sup> Figures from Deloitte economic impact study 2006.

<sup>2</sup> Research into the impact of the 2007 Grand National, conducted by England's Northwest Research Service for Economic Development and Tourism.

<sup>3</sup> Per the Deloitte study referenced above.

- In Cheltenham:
  - o the Festival brings annual economic benefit to Gloucestershire of £50 million<sup>4</sup>;
  - o over 5,000 people are employed at the racecourse during the racing, providing increased employment and also boosting local revenue by around 10%<sup>5</sup>;
- In York, at least £28 million was spent in Yorkshire as a result of York racecourse's hosting of Royal Ascot in 2005 and overall the benefit could top £50 million<sup>6</sup>;
- In Aintree, the 2007 John Smith's Grand National generated an £11 million spend in the wider area (i.e. excluding the revenue generated by the racecourse itself)<sup>7</sup>; and
- In Doncaster, the redevelopment of its racecourse has been described as a "significant regeneration project" aimed at kick starting the rebirth of communities<sup>8</sup>.

1.5 Cultural Impact: Racing also occupies a unique place in British culture. It is part of the cultural fabric of Britain.

As the report commissioned by Government in advance of the establishment on the Levy noted, horseracing was, simply: "*part of the British way of life*"<sup>9</sup>. Moreover horseracing unites British people from all sections of the community: "*Interest in horseracing is not confined to any particular sections of the community*"<sup>10</sup>. The same is true today, with the Minister for Sport noting on 21 November 2007 that "*racing is a deeply engrained pastime and part of our national sporting life ... that makes a strong and growing contribution to the economy of the country, including in some of the more deprived areas.*"

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<sup>4</sup> Per estimate of Cheltenham racecourse.

<sup>5</sup> Per The Cheltenham Business Partnership.

<sup>6</sup> Per substantial economic survey conducted by the City of York council.

<sup>7</sup> Research into the impact of the 2007 Grand National, conducted by England's Northwest Research Service for Economic Development and Tourism.

<sup>8</sup> Jon Ladd, British Urban Regeneration Association, Financial Times, 8 September 2007.

<sup>9</sup> Report of the Departmental Committee on a Levy on Betting on Horse Races, 11 April 1960 (the "Peppiatt Report").

<sup>10</sup> Per the Peppiatt Report.

In so doing, racing provides a key social benefit, the importance of which was highlighted in the Independent European Review of Sport 2006: *"part of the social function of sport is to foster integration and bring people together from different ... cultural backgrounds"*.

Speaking in the debate on the Future of British Horseracing on 21 November 2007, the Minister for Sport said:

*"The appeal of racing is universal: it appeals to people of all ages, backgrounds and socio-economic groups. Not only do more people attend racing; many more people watch it on TV."*

By way of illustration:

- 70% of key opinion formers regarded racing as one of the top sports in Britain, and 88% that racing had an important place in British culture. Other findings were that 82% believed that the sport had a bright future<sup>11</sup>.
- In the context of the Grand National, the event appealed almost equally to both sexes, with 57% of visitors being male. The event also appealed to broad social classes: 24% of visitors to the Grand National are in social class A/B, with a further 38% in social class C1. Further, evidence shows that the event is very much a social occasion: almost half (49%) of all visitors to the Grand National were travelling with friends; 23% were with family (but not children), and 6% indicated that they were in an organised group<sup>12</sup>.

In our view, the cultural significance of British racing is self evident. We would parallel the sentiments of the Culture Secretary, speaking about public service broadcasting to the Royal Television Society Cambridge Convention in September 2007:

*"...There are some good economic arguments for public service broadcasting. But, in the end, they are secondary to a cultural argument. And that is that the goods offered by broadcasting have a value to us as a nation.....It is quite common, where goods matter, to mitigate the unequal distribution that can result from the market...."*

In short, racing provides unique and special public benefits to Britain: cultural, social and economic. Racing should be supported in its efforts to do so.

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<sup>11</sup> Per a survey of key opinion formers conducted by the Authority in 2007.

<sup>12</sup> Per Research into the impact of the 2007 Grand National, conducted by England's Northwest Research Service for Economic Development and Tourism.

## **2 THE BASIS FOR DETERMINATION OF THE LEVY - ITS ROLE AND THE UNDERLYING LEGAL FRAMEWORK**

**Summary:** The Levy recognises the unique relationship between racing and the betting industry in Britain, and was established as the mechanism by which this contribution could be quantified, and a fair and reasonable return made to the sport.

The Levy is an integral part of Britain's market-led approach to betting. It is the mechanism in the British legal framework which provides for the transfer of funds from betting on racing for the underpinning and development of the sport.

In considering the "needs" of racing, the role of the Levy is to ensure that British racing not only survives, but improves; the "needs" of racing should be measured against that high standard<sup>13</sup>.

In determining the Scheme, the Secretary of State is tasked with setting a "fair and reasonable" amount for the Levy. In doing so, the Secretary of State should address the "needs of racing" and the bookmakers' "capacity to pay", but should also take proper account of other fiscal, social and economic considerations.

In order to achieve a fair and reasonable outcome we have adopted two approaches:

- (i) Firstly, we have taken the last occasion on which a Scheme was determined, the 41st Scheme which was determined in January 2002 for the period 2002/3, which included consideration of "needs" and "capacity to pay", and updated this to the conditions of 2008/09.
- (ii) Secondly, we have retained economists LECG to carry out a validation exercise, to identify the range of a reasonable return to racing based on a hypothetical negotiation between racing and betting operators that mirrors the key features of the Levy.

Racing accepts that the Levy may not be an ideal mechanism in the 21st century. The Authority remains fully committed to the goal of establishing with Government an alternative legal system to achieve the same purpose. However, for so long as no alternative structure exists, the Levy must remain, and racing will work with all agencies to ensure it is fit for purpose in terms of process and governance.

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<sup>13</sup> See Sections 2.3 and 3.1.

## **2.1 The underlying justification for the Levy - Racing's importance to the betting industry - their special relationship**

**Summary: The Levy recognises the special relationship between racing and the betting industry.**

The health of British Horseracing is directly important to the UK betting industry; the two have been and remain symbiotic, although the balance of the relationship has changed rapidly in recent years, and still further in recent months. The Levy must be increased so as to reflect this change. Racing and betting have developed together since off-course fixed odds bookmaking on racing was legalised by the Betting Levy Act 1961. The result is a uniquely British phenomena, and the Levy recognises the unique position in which horseracing finds itself.

The point was made by Mr Elystan Morgan who, when introducing the Horserace Betting Levy Act 1969, stated that:

*"It is very much to [the bookmakers'] benefit that the financial viability of the sport should be maintained, and it is, therefore, as much a matter of self-interest as of obligation that they should contribute to it."*<sup>14</sup>

These sentiments were recently echoed by Richard Caborn, then Minister for Sport:

*"The horse race betting levy recognises the unique relationship between that sport and the betting industry. Horse racing is a sport whose primary purpose is to provide a betting product. In that respect, it is a symbiotic relationship not shared by other sports, except perhaps greyhound racing which has a separate arrangement with bookmakers."*<sup>15</sup> He later reiterated that *"The horserace betting levy acknowledges the special relationship between horse racing and betting, and was established back in the 1960s on that basis"*<sup>16</sup>.

In short, the betting industry has relied, and continues to rely, upon British racing as its core product. The Levy was established as the mechanism by which contribution be recognised, and a fair and reasonable return made to racing for that contribution.

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<sup>14</sup> Similarly, in his introduction of the Peppiatt Report to the House of Commons via a private member's motion in 1960, Eric Johnson MP commented: *"The answer to the question, why should the bookmakers be called to subsidise owners, is that they are not asked to do anything of the kind. Off-the-course bookmakers are simply asked to make a reasonable contribution to racing and thus make it possible for more people to go in greater comfort to watch the sport which provides a living for thousands of bookmakers, most of whom pay nothing at all towards it. ... I do not think that off-the-course bookmakers should be able to make an income from an industry to whose costs they contribute virtually nothing."*

<sup>15</sup> 5 June 2006.

<sup>16</sup> 23 January 2007.

## **2.2 The role of the Levy**

**Summary: The role of the Levy is clear: it should ensure that, in recognition of its sporting, economic, social and cultural benefits, British racing not only survives, but improves<sup>17</sup>.**

It is worth recalling the fundamental purposes of the Levy. The starting point is the Betting Levy Act 1961<sup>18</sup>, which established the Levy Board to assess and collect a levy on bets on horseracing and distribute it for purposes conducive to:

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

We would add to this as follows:

### **(a) To improve horseracing**

- (i) The Levy is intended to help to improve British racing. The Levy is not to be regarded as a payment which acts merely as a payment of last resort, or as a correcting payment. The Levy is therefore not to be set at the minimum possible level to maintain the status quo but rather must also achieve the purpose of improving British racing.
- (ii) This was made clear from the very outset: In the Peppiatt Report, commissioned by the Government in advance of introducing the Levy in 1961, its authors stated they did not: "*think that it is necessary to establish that horseracing is declining to justify a levy. The United Kingdom has for a long time been in the lead in horse racing and [the Committee thought] that the infusion of fresh money [i.e. the levy] should be regarded not as serving to bolster a declining industry but as an aid to improving it.*" This reasoning was referred to by the then Home Secretary (Mr R Butler) as providing the "desirability" for the imposition of a Levy system.

### **(b) To provide wider economic and cultural benefits**

- (i) We have set out at Section 1 above some of the many wider benefits provided by racing and which are made possible by the Levy. One purpose of the Levy is to bolster these benefits.

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<sup>18</sup> As amended.

- (ii) In particular, expenditure on the Levy is justified where it brings additional benefits which exceed the cost. This position was clearly advocated in the Organisation Consulting Partnership Report (OCP) report prepared for the Secretary of State in advance of the Determination of the 41st Levy, which stated: *"It is a general economic principle that additional expenditure or activity is worthwhile if its benefits exceed its costs. In most cases benefits can be judged from what prospective purchasers are prepared to pay and costs from what sellers require and so the normal operation of the market can be relied on to achieve a sensible outcome. However, there may be circumstances in which benefits or costs accrue to persons other than the purchaser or seller. In this case, betting on horses relies on the existence of horseracing and many activities of the horseracing industry will yield benefits for betting and punters."*
- (iii) The OCP Report went on to say that: *"Although the levy is not a payment for a product, in assessing the needs of racing, it is useful to consider whether activities have overall benefits that exceed their costs and the revenue they can obtain within racing and, in particular, whether they yield benefits for betting."*
- (iv) In Section 1 we have identified some of those means by which investment in racing benefits the wider community. We will consider further elsewhere how racing provides wider benefits to the betting industry<sup>19</sup>. In our submission, these benefits, generated by the investment in racing permitted by the Levy, represent a disproportionately high return, as against the cost of the Levy to the betting industry<sup>20</sup>, and are therefore self-evidently justified.
- (c) To address challenges
- (i) The Levy must be sufficient to enable it to counteract the problems, and overcome the challenges, faced by racing - such as those issues highlighted in Section 3.1 below.
- (ii) When introducing the Levy in 1961, the then Home Secretary (Mr R 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. If, as a result of the [1961 Levy Act], public support for horse racing can be maintained and increased, that purpose will*

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<sup>19</sup> See Section 3.

<sup>20</sup> In particular, we would ask the Secretary of State to note that a significant number of racecourses operate as trusts or not for profit organisations. It follows that the level at which the Levy is set is not a debate about shifting profit from one organisation to another. Rather it is about the directing of money into racing where it serves many functions in terms of creating jobs, upholding the integrity of sport and promoting Britain, rather than simply maximising shareholder dividends. It follows that the benefits (economic, social and cultural) to Britain will be greater via ensuring additional investment in racing through the levy than they would be if that same additional sum was retained by betting operators.

*be further advanced by the [Act]. In my view, it is in the national interest that our prestige and, indeed, our pre-eminence in the breeding and racing of bloodstock should be maintained. I believe that this [Act] will help to maintain it."*

(d) Summary of the role of the Levy

- (i) It is therefore clear that in determining the appropriate amount for the Scheme, and in particular the "needs" of racing, it is not enough to assess what is required simply to maintain a status quo, remedy current problems and meet current costs (although it follows from our arguments above that the Scheme should clearly be sufficient to do so). It is also necessary to consider what is required to improve the standard of the racing product and promote advances.
- (ii) It follows that, in order to properly fulfil his duties in conducting this Determination, the Secretary of State should have regard to what level of funding is necessary not merely to maintain the status quo in racing, or to save the sport from further decline, but rather what is necessary to improve the racing industry: and thereby improve the experience of those attending race meetings, support the racing workforce and other constituent members of British racing, to create and improve important cultural landmarks and experiences, increase attendances and enhance the experience of the racing punter.
- (iii) It also follows that the widest possible view of building on racing's social, economic and cultural contribution has to be taken into account.

**2.3 What must be taken into account when determining the Levy?**

**In determining the Scheme, the Secretary of State is tasked with setting a fair and reasonable Levy. In doing so, he should address the "needs" of racing and the bookmakers' capacity to pay but should also take account of other fiscal, social and economic considerations.**

**It would be counter-intuitive to take a narrow, restricted view of any part of that Determination, including the consideration of bookmakers' capacity to pay – instead, the Secretary of State should properly have regard to the prevailing economic, social and fiscal conditions at all times, including when assessing the bookmakers' capacity to pay.**

As is well –known, the relevant legislation leaves silent the question of what factors should be taken into account when determining the Levy.

In transferring responsibility for making a Determination away from the independent members of the Levy Board and onto the Secretary of State, the Horserace Betting Levy Act 1969 ("**1969 Act**") left the Levy Determination to the discretion of the Secretary of State. In determining the Levy, it is therefore

necessary for him to make an informed decision that takes proper account of all relevant circumstances.

In particular, the 1969 Act removed any reference to the Needs/Capacity to Pay test from the Statute books<sup>21</sup>.

The House of Lords has confirmed that Hansard can be used as an aid to statutory construction where the legislation is ambiguous or obscure and the material relied on consists of clear statements made by a minister or other promoter of the Bill<sup>22</sup>. Given the breadth of his discretion under statute, the Secretary of State may be guided in what he should take into account by those who presented the 1969 Act in Parliament:

- "Needs" and "capacity to pay" still relevant: When introducing and debating the 1969 Act, Mr Elystan Morgan (the Promoter of the Bill) gave the House of Commons the assurance that: "In exercising the functions conferred on him ..., the Home Secretary will have regard to the capacity of the bookmakers to pay ..... At the same time, he will have regard to the needs of horseracing. *I cannot see how the Home Secretary could carry out this function without having regard to these factors, but I am fully aware of the anxieties that have been expressed by the bookmakers and, for that reason, I give that considered assurance*" (our emphasis).
- Other factors are also relevant: The Promoter also made clear that the needs of horseracing and the capacity of the bookmakers to pay are not the only factors to be considered: "*The Secretary of State will have to weigh the considerations I have outlined [i.e. needs and capacity to pay], but they may not be the only ones. The transfer of this responsibility to a Minister of the Crown must enlarge the perspective of judgment as compared with that which was vested in the independent members of the Levy Board. The public interest may require certain other considerations, fiscal, social or economic, also to be taken into account.*"

He continued: "*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 (our emphasis)*".

A more recent formulation of the principle evinced by those who created the 1969 Act can be found in the comment of Richard Caborn,

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<sup>21</sup> See Appendix 2 for a summary of the relevant legislative framework.

<sup>22</sup> Pepper v Hart [1993] AC 593.

on 14 December 2006: *"The Government has decided ... to retain the ... levy scheme ... on the basis that the scheme continues to reflect and balance the legitimate needs of racing against the ability of bookmakers to pay in accordance with the prevailing economic conditions"*.

Having weighed these considerations, it is for the Secretary of State to set a "reasonable" Levy<sup>23</sup>. Again, per the Promoter of the 1969 Act: *"the intention at which we are aiming is to determine not what bookmakers are capable of paying, but what it is reasonable for them to pay."*

This sentiment has been echoed, albeit using slightly different phraseology, that of "fairness", on several subsequent occasions:

- by Stephen Timms, then Treasury Minister, who commented that "any benefits of the reform are fairly shared with racing<sup>24</sup>";
- by Tessa Jowell, the Secretary of State for Culture, Media and Sport, when announcing the 41st Levy, made it clear that she was seeking to achieve the "fairest" scheme; and
- by the current Minister for Sport, who stated that, in relation to the Levy Determination, he is "fully aware of the importance of having fair and timely outcomes for the racing industry<sup>25</sup>".

In light of the above, racing's position is that the outcome being sought through Determination is a "fair and reasonable" return to racing, and that is the terminology we use in our submission. Therefore:

- in order to properly exercise the broad discretion available to him under the 1969 Act, the Secretary of State should take account not only of the broad concepts of "need"<sup>26</sup> and "capacity to pay"<sup>27</sup>, but also

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<sup>23</sup> Racing's preference is that this ideally should reflect the reasonable value of racing to the betting industry - Support for this proposal can be found, for example, in the Court of Appeal's judgement in the *Attheraces v British Horseracing Board* from early 2007. When discussing the economic value of pre-race data (ultimately determining that the lower court had been incorrect to conclude that the price being charged by racing was excessive and unfair), the Court of Appeal stated that it should not be confined to the cost of data compilation plus a reasonable return to the compiler, but should also take into consideration "the value of the pre-race data to ATR in determining [its] economic value". So in order to calculate a fair and reasonable price or return, the value of the supplier's product (in this case racing) to the recipient must be taken into account.

<sup>24</sup> 23 January 2001, albeit that the comments were in relation to the introduction of the gross profits tax.

<sup>25</sup> 21 November 2007.

<sup>26</sup> As set out in Section 3.1.

<sup>27</sup> As set out in Section 3.2.

of the prevailing economic, social and fiscal conditions. Consideration should be given (inter alia) to the contrasting economic fortunes of racing and the bookmaking industry<sup>28</sup>, and the important economic, social and cultural role played by British racing<sup>29</sup>; and

- it follows that it would be counter-intuitive to take a narrow, restricted view of any part of that Determination, including the consideration of bookmakers' "capacity to pay". Instead, the Secretary of State should properly have regard to the prevailing economic, social and fiscal conditions at all times, including when assessing the bookmakers' capacity to pay<sup>30</sup>.

## **2.4 How to Determine a "Fair and Reasonable" Return in the 47th Scheme**

**Summary: Racing has adopted and proposes two routes to assessing a fair and reasonable return via the Levy:**

- **the first (Methodology 1) takes the last occasion on which a Scheme was determined, the 41st Scheme which was determined in January 2002 for the period 2002/3, and updates this to the conditions of 2008/09.**
- **the second (Methodology 2) takes the analysis that has been carried out by economists LECG, commissioned to identify the range of a reasonable return to racing based on a hypothetical negotiation between racing and betting operators that mirrors the key features of the Levy. This is intended to test and validate the analysis under Methodology 1.**

As is widely recognised, the Determination process is complex. Racing has throughout the process sought to adopt and promote a reasonable approach in order best to deal with this complexity.

The first assumption is that the overarching framework of the Levy remains, including that the Levy will be expressed as a proportion of gross profits. As

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<sup>28</sup> As set out in Section 3.

<sup>29</sup> As set out in Section 1.

<sup>30</sup> The Bookmakers' Committee have argued that the Secretary of State, when assessing the amount of the horserace betting levy, should only take into account income directly derived from British horseracing. In particular, the bookmakers assert that: "*it is fully established that the only legitimate basis for assessing the capacity of bookmakers to pay the Levy is the gross profits they derive from their British horseracing business*". The Bookmakers claim support for this argument by reference to the OCP Report on the 41st levy Scheme, which stated that "*it seems illogical to set a levy on one type of income – horseracing – but to justify it on the basis of a wider definition of income*". In our view, this assertion is incorrect and has no basis in law. Indeed, as we have demonstrated above, it is clear that those who framed the Levy determination process envisaged that a much broader investigation should take place. As is well known, the relevant legislation leaves silent the question of what factors should be taken into account when determining the Levy.

is stated below, we believe that this methodology in itself gives considerable economic power to betting operators. The Scheme creates a profit share relationship with no minimum payment obligations, no audit provisions, and no promotional obligations on betting operators for them to maximise betting on racing, and the profit levels on this activity. Now that betting operators are able to promote a wide and diverse range of products, racing is placed at a real disadvantage. A profit share arrangement with no further conditions may have been appropriate in the environment that used to apply, but in the modern environment it raises many issues.

Taking this assumption, we have adopted two approaches:

- (i) Firstly, we have taken the last occasion on which a Scheme was determined, the 41st Scheme which was determined in January 2002 for the period 2002/3, and updated this to the conditions of 2008/09.
- (ii) Secondly, we have retained economists LECG to identify the range of a reasonable return to racing based on a hypothetical negotiation between racing and betting operators that mirrors the key features of the Levy.

Our primary methodology has the advantage of addressing the need for a consistency in approach between the two decisions by different Secretaries of State. This is a key component of achieving a reasonable decision.

### **3 METHODOLOGY 1**

#### **3.1 RACING'S NEEDS<sup>31</sup>**

**Summary: Horseracing continues to face all of the costs and challenges it faced at the time of the last Levy Determination in 2002. In addition racing faces challenges such as the real challenge of globalisation and the superior prize money available outside Britain, and also those created by the changing betting market. These increased challenges mean increased costs to racing, and we set them out below.**

**It cannot be reasonable for these costs to be met through the re-direction of investments in other aspects of racing and/or returns to owners, employees and other participants. Racing's participants are bearing a disproportionate share of the costs, while betting operator returns are very high. To continue risks precipitating the decline of the sport.**

**Consequently, if the Levy does not significantly increase in real terms over that set in 2002, there will be funding shortfall to racing. If racing is to address the additional challenges and costs it faces, it would need to divert funding from its existing cost centres. The resulting "squeeze" will lead to a period of decline within the sport and the benefits that it provides to Britain (economic, social and cultural) will wither. Yet, as we have identified at Section 2.2, the Levy should be set at an amount which allows racing to improve. Therefore, in our submission, the Determination must result in a significantly increased Levy Scheme.**

British horseracing continues to face all of the costs and challenges which it faced at the time of last Levy Determination in 2002. The following table sets out a summary of how the Levy is currently spent by British horseracing:

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<sup>31</sup> Section 24 of the Betting, Gaming and Lotteries Act 1963 set out the purposes for which the Levy payments should be used, which are as follows: the improvement of horse racing; the advancement or encouragement of veterinary science or veterinary education; and the improvement of breeds of horses. We set out below the challenges and needs faced by racing which go to one or more of these purposes.

## **HORSERACE BETTING LEVY BOARD – ANALYSIS OF EXPENDITURE<sup>32</sup>**

<b>(£000)</b>	<b>1</b>	<b>2002/03</b>	<b>2006/07</b>	<b>2007/08</b>
		<b>Actual</b>	<b>Actual</b>	<b>Forecast</b>
<b><u>IMPROVEMENT OF HORSERACING</u></b>				
<b><u>Owners</u></b>				
Prize Money:				
Main Fund		42,029	61,232	53,625
Divided Races Fund		2,139	798	926
Owners' Premium Scheme		0	664	0
Development Fund		0	0	550
Appearance Money Scheme		2,501	2,700	1,500
		46,669	65,394	56,601
<b><u>Racecourses</u></b>				
Abandonments: Flat / Jump		545	540	450
Fixture Incentive Scheme		6,054	6,676	5,894
Foot and mouth and security grants		113	0	0
		6,712	7,216	6,344
<b><u>Integrity</u></b>				
Fixture Fee Grants	2	6,803	10,411	11,515
Regulatory Head Office Grants	2	0	4,140	4,299
Integrity Fee Grants	3	6,735	5,398	5,755
HSAP and Related Bodies		25	0	0
Cost of HFL integrity services	2	3,048	3,775	4,157
New Threats - Research project		0	289	294
		16,611	24,013	26,020
<b><u>Training</u></b>				
Industry Training & Education		0	902	979
Stable and Stud staff training		1,038	0	0
		1,038	902	979
<b><u>Other</u></b>				
Point-to-Points		198	327	325
Research & Development		(37)	34	37
IBAS		0	65	40

<sup>32</sup> Key to diagram: 1. Source: HBLB Annual Reports and HBLB Financial Forecasts; 2. These three items combined form the total integrity funding received ultimately by the British Horseracing Authority for provision of the services described in Section 3.1; 3. Grants made to racecourse to fund the provision of integrity patrol cameras and photo finish. The figure for 2002/3 also includes the cost of starting stalls. This is now borne directly by the racecourses and is excluded from the analysis in this paper; 4. A lump sum payable into the Scheme upon the launch of BHA in July 2007. This payment represented a cashflow acceleration of payments due to be made in future years and, therefore, it has been excluded from the analysis of integrity costs throughout this paper; 5. The cost of sales for the operations of HFL Ltd other than the provision of integrity services to racing. The commercial income for these services provided to third parties is included in the HBLB published accounts. HFL Ltd was a wholly owned subsidiary of HBLB, and was sold by HBLB on 25 January 2007.

<u>(£000)</u> (cont'd)	1	2002/03	2006/07	2007/08
		Actual	Actual	Forecast
Training Gallops		0	250	0
TRICL IV		0	153	0
Channel 4 Racing		0	734	687
Others		7	46	12
Marketing		3,035	0	0
BHA Pension Scheme Contribution	4	0	0	6,450
Grant to Northern Racing College		250	0	0
		<b>3,453</b>	<b>1,609</b>	<b>7,551</b>
Sub total - Improvement of horseracing		<b>74,483</b>	<b>99,134</b>	<b>97,495</b>
<b>OTHER EXPENDITURE</b>				
<u>Improvement of Breeds</u>				
Breeders' Prizes Scheme		2,086	1,510	2,010
Breed Societies		125	172	172
National Stud Endowment Grant		0	0	1,100
Sub-total		<b>2,211</b>	<b>1,682</b>	<b>3,282</b>
Veterinary Science and Education		1,701	2,214	2,275
Charities		72	81	83
Administration Costs		2,894	3,372	3,329
Laboratory operating expenses	5	2,930	3,916	0
Bookmakers' Committee Costs		264	200	261
HBLB Pension Costs		0	396	300
Sub total - other expenditure		<b>10,072</b>	<b>11,861</b>	<b>9,530</b>
<b>TOTAL EXPENDITURE</b>		<b>84,555</b>	<b>110,995</b>	<b>107,026</b>

In addition, racing now faces new challenges. These mean increased costs to racing, and we set them out below.

### **3.1.1 Increased Fixtures**

**Summary: Substantially, in response to betting operators (predominantly off-course bookmakers) identifying times at which they wanted more British racing product, racing has dramatically increased the number of fixtures and races held since 2002. The costs associated with staging these additional fixtures amount to £22 million, together with less quantifiable increases such as increased overheads and overtime payments. It follows that a substantial increase in the Levy is required.**

(a) Racing has responded to the betting industry's demand for an increased fixture programme

Part 1 of the British Horseracing Board's Racing Review, published in April 2003, noted that bookmakers had clearly identified the times when they wanted more British racing product and that over 20% of that required product was not being supplied. There were 303 occasions in the bookmakers' criteria for paying for pictures for licensed betting offices when one of these requirements was not met. This meant that British racing was failing to meet over 20% of the betting industry's demand for fixtures. British racing has met the request for additional product, expanding the fixture list as quickly as infrastructure will allow in order to meet the betting industry's aspirations:

- The British racing programme increased to 8,934 races in 2006 from 7,691 in 2002, a 16% increase.
- The British racing fixture list has increased from the 1,158 fixtures that took place in 2002 to a published 1,504 fixtures in 2008, a 30% increase.

(b) The result is substantial additional costs to racing:

(i) The additional gross costs to British racing associated with facilitating the expansion from 2002 to 2008 is **£22m**, comprising:

<b>Cost</b>	<b>£m</b>
Prize money / appearance money / breeders' prizes	11.6
Fixture incentive payments	2.0
BHA direct regulatory & governance costs	5.3
Photo finish and camera patrol costs	1.8
Drug surveillance and research services	1.3
<b>Total</b>	<b>22.0</b>

(ii) Whilst the betting opportunities provided by the additional fixtures are intended to increase bookmaker profits on racing, we also understand that the fixtures do, and are often primarily intended to, increase profits on other products available in betting shops<sup>33</sup>.

(iii) This rapid expansion of the product has resulted in British racing incurring further additional – albeit less easily quantifiable - costs. These have included, for example, increased racecourse overheads and also the costs

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<sup>33</sup> See below for our case that the bookmakers' FOBT and other non-racing betting business lines are specifically linked to racing and that they must be taken into account regarding the betting industry's capacity to pay.

associated with a relatively fixed, skilled workforce being required to suddenly increase output, often involving unsociable working hours. These are also “brand” issues where greater provision of product is inevitably at the lower end of the quality scale, risking the key qualities of the British racing Experience. However, given the inherent difficulties in quantifying such factors, these areas have been excluded from our financial analysis<sup>34</sup>. Despite being of value, we see this as a reasonable approach to take in this Determination.

- (c) Therefore, racing needs these increased costs to be met from an increased return through the Levy:

It follows that in our submission, the Levy should increase to reflect the fact that racing has incurred additional costs for additional fixtures since 2002/03, whilst the betting industry has benefited disproportionately given the relative importance of British racing. Failure to do so leads to a situation in which racing creates product at its own expense, yet does not share in the return provided to the bookmakers.

We would also note that a single rate of Levy return fails to properly and adequately recognise a risk/reward sharing relationship between betting operators and racing. Where significant investment is made by one party in an untested return environment it would be reasonable to assume a higher share of returns from a counter-party (i.e. betting). The Scheme does not currently allow for this.

### **3.1.2 Increased integrity and regulatory costs**

**Summary: Changes to the betting market (and in particular the development and growth of betting exchanges) have meant that since 2002 there has been a significantly enhanced cost requirement attached to maintaining the integrity and regulation of horseracing. Integrity and regulation are core tasks of the Authority on behalf of racing, which has substantial impact on promoting confidence in betting on racing. Spend in this area has increased from £15 million to £24 million from 2002 to 2007, with a projected £25 million in 2008.**

**Racing is the acknowledged leader in this field and needs to ensure existing levels of integrity and regulation are maintained or improved to meet the challenges of the modern betting environment.**

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<sup>34</sup> An further intangible cost to the industry of these additional fixtures is their negative impact on the brand and image of the sport. The quality pyramid of the horses in training dictates that if a bulk of additional fixtures are required to be staged, then only by staging races for the horses at the high quantity low quality base of the pyramid are available to race. Both racing media and international competitors refer to the notion of British racing ‘dumbing down’.

- (a) The need for integrity and regulatory services is vital to protect racing as a betting product and has increased as a result of the rise in betting exchanges
- (i) Strong integrity, regulatory and security measures are integral to protecting the reputation of British racing as a betting product, and the Authority leads the world in the regulation of sports betting related activity<sup>35</sup>.
- (ii) Since 2002 racing's integrity and regulatory efforts have been forced to respond to a significant new challenge in monitoring betting activities and associated results of races, largely as a result of the growth of betting exchanges.
- (iii) The betting industry benefits from racing's initiatives to enhance integrity and regulation, many of which stem from the involvement of betting. This relationship was recognised in the OCP report (paragraph 3.22) which found that *"Services to police the fairness of racing provide obvious benefits to those betting on the outcome. It is probable that an efficient level of provision will require substantial funding from outside racing."*
- (b) The result is substantial increased costs to racing:
- (i) Since 2001, racing's centrally funded expenditure on integrity and regulation has risen from £15 million to £22 million in 2006<sup>36</sup>. Total central spend will exceed £25 million in 2008 as the fixture list continues to expand.
- (ii) This increased investment is the result of a major review in 2002 of the sport's integrity provision, which led to an overhaul of the (then Jockey Club's) Security Department. These changes included a significantly strengthened and more professional team including former senior police detectives, intelligence specialists and betting analysts; the introduction of sophisticated information technology and surveillance equipment; and intelligence links to the betting industry. The integrity services associated with British racing are wide ranging in nature:
- the team of officials, such as Starters, Judges, Stipendiary Stewards and Vets, who work at the racecourse overseeing the conduct of a day's racing;
  - the drug surveillance and research services provided under contract to the Authority by HFL Ltd;
  - the team at the Authority's head office who license the sport's participants such as jockeys, trainers and stable staff, as well as a team who both

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<sup>35</sup> The Association of Tennis Professionals recently sought guidance from the BHA Integrity team in relation to a match in Poland; In 2005, the BHA Integrity team hosted a seminar for British Sport on behalf of the then Minister for Sport, Richard Caborn MP, to agree common approaches to the regulation of sport and its links to betting activity.

<sup>36</sup> We have excluded from our analysis the cost of starting stalls, as these were centrally funded in 2001 but by 2006 the responsibility for funding had passed to the racecourse.

advise and license racecourses based on best practice methods of turf management, course building and health & safety;

- the head office team who manage the disciplinary process away from the racecourse;
- the security and integrity services team who provide raceday security at the racecourse in the weighing room and at the stables, monitor and scrutinise on and off course betting activity as a preventative security measure and investigate potential breaches of the Rules of racing; and
- the provision at the racecourse of photo finish and camera patrol services, which monitor each race from up to six angles.

- (iii) In 2008, there are an additional 89 planned fixtures to be serviced by the regulatory raceday teams and several new policy initiatives deemed necessary are targeted for implementation by the new Authority, the largest of which would be a major overhaul of the security of racecourse stables. The total cost of integrity and regulation services, based on calendar year expenditure<sup>37</sup>, is given below<sup>38</sup>:

Year	Integrity Costs (£m)
2001	15.0
2002	16.2
2003	17.4
2004	19.8
2005	21.3
2006	22.2
2007*	24.3
2008**	25.3

\*Forecast

\*\*Budget

- (iv) Even allowing for the dramatic increase in the fixture list, total costs per fixture have now increased from £14,000 per fixture in 2001 to a forecast £17,000 per fixture in 2008.
- (v) These cost increases are a direct response to the challenges of the relationship between racing and betting, and particularly those presented by the modernised betting operators both in Britain and abroad. Moreover they

<sup>37</sup> The Levy Board operates to a standard fiscal year. In contrast, British racing operates to a calendar year, in line with the publication of an annual fixture list. For this reason, not all financial comparatives are directly aligned.

<sup>38</sup> Excluded from the analysis above is the cost of the starting stalls required for flat racing. For a long period of time, these were funded centrally from Levy income but in 2005 Levy funding was withdrawn in order to give greater central support to prize money. Although the stalls play a vital part in ensuring that races are properly run, it was agreed that their costs were more appropriately borne directly by racecourses and it was considered, therefore, that they should be excluded from this financial analysis.

operate to the direct benefit of the betting industry: greater investment in monitoring benefits the business in particular of the exchanges. Yet currently the Levy provides no mechanism by which this extra investment is reflected in greater Levy return.

- (c) Therefore, racing needs these increased costs to be met from an increased return through the Levy:

The Levy yield currently fails to provide any true correlation between the value provided to the betting industry from racing's integrity and regulation operations, and the costs incurred by racing. Increased integrity and regulatory costs with significant benefits to betting, and in response to issues relating to betting, are being met by racing from a declining budget, while betting industry profits grow. We submit that this result is unreasonable, and the Secretary of State should take the opportunity to rebalance this misalignment in his determination. It cannot be fair or reasonable for these costs to be met through the re-direction of other investments in racing and/or returns to owners, employees and/or other participants in racing. Foreign competitors seek to make competitive advantage of a perceived higher threat of competition from the market-led betting approach. Racing is disproportionately meeting the cost.

### **3.1.3 International competition and prize money**

**Summary: Prize money available in Britain is reducing in real terms against our rivals. Consequently, Britain is low in international prize money rankings in comparison with other major racing nations. The number of talented horses training in Britain has started to decline, and the number of horses exported overseas has increased. In order to make Britain an attractive base for the best horse stock, and to sustain the quality of racing required to preserve Britain's reputation as a world leader, there is a need for additional prize money through the Levy's central funding mechanism.**

- (a) The importance of prize money
- (i) Prize money underpins the financing of the sport. It is also the key measure of racing's international competitiveness, with top-class horses increasingly directed to wherever the rewards are greatest. At lower levels, returns have an important influence on individuals' decisions on whether to remain as owners. A survey of 219 lapsed owners conducted for the Racehorse Owners Association in 2007 showed that "prize money too low compared to costs of ownership" was in the top two reasons for 75% of respondents<sup>39</sup>.

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<sup>39</sup> Lapsed Racehorse Ownership Study, May 2007

- (ii) In their 2001 report, OCP stated at para 3.13 that *“the need for additional prize money is not established but neither is the converse, that additional spending would be inefficient”*.
  - (iii) Racing's case is that, even if the OCP report was correct and it was not established then<sup>40</sup>, there is now an urgent need for additional prize money through the Levy's central funding mechanism. The need is particularly great in the modern economic context of a truly globalised racing market place, which is a change that has occurred since 2002/03. Globalisation is having a very real impact.
- (b) The challenges posed by foreign racing
- (i) The rise of internationally competitive races and jurisdictions around the world, such as the UAE, has meant significant new competition to the sport in Britain. A growing number of end-of-season races provide highly attractive alternatives to events which historically had shaped the British flat season. Given the needs of racehorse owners to make strategic decisions as where to race their horses so as to maximise return and maintain their horses in the best condition, it is not necessary for direct scheduling clashes to arise between Britain and overseas races for overseas races to compete with British races for the best competitors.
  - (ii) Prize money is a significant factor in attracting the best competition and therefore enhancing the quality of racing<sup>41</sup>. Prize money is also relevant in terms of Britain's ability to attract investment by owners. It follows that prize money is a key expenditure item from Levy payments. Yet, in Britain, prize money lags behind our major competitors, and the gap is widening. Prize money is not the only factor in ensuring that British racing continues to hold its special position in the global calendar, but it is a significant one. Prize money is seen as the last funding requirement in the current Levy process. This is wrong. Betting operators are not paying a fair and reasonable amount under the Levy, meaning that prize money has to meet the shortfall. In effect, betting is receiving a greater return on investment at the expense of owners.
  - (iii) Figures from the International Federation of Horseracing Authorities for 2006 show that the return to owners from prize money as a proportion of training costs in Britain was 24%, the lowest of all major racing nations. The 2006 percentage return of betting turnover to racing shows Britain at the bottom of the table.

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<sup>40</sup> Which racing disputes.

<sup>41</sup> Those races which compete with British races for the attention of racehorse owners are largely based in countries which have a state sponsored tote or betting monopoly, enabling particularly high levels of prize money. British racing takes place in the uniquely different market economy betting industry. Competitor jurisdictions are able to highlight how this structure leads to less attractive prize money, and use it as a marketing tool against British racing.

**PERCENTAGE OF BETTING TURNOVER RETURNED TO RACING 2006**

Germany	12%
France	8%
USA	8%
Hong Kong	2%
Britain	1%
Japan	n/a
South Africa	n/a
Italy	n/a

Source: IFHA

**PERCENTAGE OF PRIZE MONEY AS A PROPORTION OF TRAINING COSTS  
RETURNED TO OWNERS 2006**

Hong Kong	113%
Japan	66%
France	56%
South Africa	52%
Italy	46%
Ireland	28%
Germany	26%
Britain	24%

Source: IFHA

- (iv) Britain's current relatively poor prize money performance in relation to its international competitors is illustrated by the table below, which identifies the location of the world's 40 most valuable races in 2006 (the Derby being Britain's sole entry):

**COUNTRIES STAGING THE WORLD'S 40 MOST VALUABLE RACES  
2006**

<b>Country</b>	<b>Number of Races</b>
Japan	11
USA	9
Hong Kong	5
Dubai	5
Australia	4
France	2
Britain	1
Canada	1
Ireland	1
Singapore	1
<b>Total</b>	<b>40</b>

Source : International Racing Bureau

- (v) British racing is facing significant pressure in the international environment. In the recent years, prize money levels in leading (Pattern and Listed) races has declined relative to our main international rivals, France and Ireland, as illustrated in the table below:

**MEDIAN PATTERN RACE PRIZE MONEY VALUES**  
**BRITAIN, FRANCE & IRELAND**

	GB £k	France £k	Ireland £k
Group 1 – 2yo			
2000	175	130	145
2006	170	204	204
Group 2 – 2yo			
2000	50	57	n/a
2006	70	109	85
Group 3 – 2yo			
2000	40	35	34
2006	40	54	54
Group 1 – 3yo+			
2000	270	122	160
2006	317	204	272
Group 2 – 3yo+			
2000	100	49	60
2006	100	88	85
Group 3 – 3yo+			
2000	40	35	34
2006	50	54	54

- (vi) The erosion of Britain's reputation as the home of the world's best racing has a number of consequences. By way of example, the number of talented horses training in Britain has started to decline. Taking June as the base month, which is recognised as a representative month, the following table shows the total number of horses rated 101 and above on the Flat.

**HORSES-IN-TRAINING RATED 101 AND ABOVE**  
**JUNE 2003 TO 2007**

Year	2003	2004	2005	2006	2007
Number of Horses	365	350	354	336	328

- (vii) The number of permanent exports from Britain, as recorded by Weatherbys, has shown considerable increase in recent years, with a comparison of 2003 and 2006 identifying a rise of 18.6% (from 2,900 to 3,439). They comprise a significant number of those included in the exports to countries such as USA (381), UAE (300) and Japan (145) where prize money levels are relatively high compared with Britain.
- (viii) The reduction in the number of such able horses based within Britain has impacted upon the quality of the Pattern and Listed events staged in Britain, as measured by the Annual Ratings generated by each such race. The table below identifies the increasing number of such races that have failed to attain the minimum rating parameters, as set by the European Pattern Committee, during this period:

**BRITISH PATTERN AND LISTED RACES FAILING TO ACHIEVE THE**  
**MINIMUM RATING PARAMETER 2003 TO 2006**

Year	Pattern Races		Listed Races		Total Races	
	Number	%	Number	%	Number	%
2003	10	8.1	23	15.2	23	12.0
2004	20	14.9	32	21.8	32	18.5
2005	18	13.2	26	17.7	26	15.5
2006	24	17.4	33	22.4	33	20.0

- (ix) The ownership of racehorses in yards in Britain and the running of horses in Britain is fundamental to the sport and the betting that takes place on it. Yet ownership remains uneconomic with the result that, at the top end of the sport, particularly on the Flat, ownership is dominated by a small number of predominantly overseas-based individuals. By way of example, only one of the top ten owners by Flat prize money won in Britain in 2007 is of British nationality. The implication is that these factors leave the sport vulnerable to a withdrawal of support from these overseas owners. British racing is trading on its heritage without a strong domestic ownership base.
- (c) Therefore, racing requires additional prize money costs to be met from an increased return through the Levy:
- (i) It follows that in our submission, current prize money levels are inadequate and additional investment must be diverted to prize money in order to arrest the negative trends referred to above. Failure to do so poses a very real risk of decline in racing: interest in British racing's landmark Flat fixtures and races could be severely impacted by reductions in their relative standing of

those races by reference to prize money<sup>42</sup>. It follows that we submit that one of racing's key requirements in the forthcoming period is to encourage financial incentives in the form of prize money so as to encourage inward investment by improving rates of return on investment to owners.

- (ii) Racing should not have to divert investment from other areas or from owners' contributions in order to meet this additional need for increased prize money - to require it to do so is not fair or reasonable. To do so would simply lead to a decline in standards. It follows that the prize fund available via the Scheme should increase in real terms.
- (iii) Prize money also underpins the jobs and remuneration of the employee force in racing, both directly and indirectly. The distribution of prize money to a wide range of recipients in the sport is governed by BHA Order 194. Under the 2007 rules, approximately 80% of prize money goes to owners, 8% to trainers, 6% to jockeys, 5% to stable staff. The remaining 1%, which totals some £1 million, is divided between Industry Training, the jockeys' valets' fund, the jockeys' pension fund and the National Association of Stable Staff. This distribution mechanism therefore ensures fairness in the way that prize money is distributed to all key sectors of the sport.

#### **3.1.4 Increased marketing and promotional requirements**

**Summary: The promotion of racing, in particular as a betting opportunity, is vital. In the absence of any requirement through the Levy Scheme that bookmakers and other operators promote the sport with which they share a special relationship, racing is left in a position where it must, at its own expense, promote betting on racing. This cannot be fair or reasonable given that it is the betting industry who can more effectively and efficiently promote betting on racing. The Levy return should reflect the cost of such marketing and promotion to benefit both racing and betting.**

- (a) The need for marketing of the racing product are vital to protect and enhance racing as a betting product and a sport.
  - (i) The continuing diversification of the betting industry (considered in further detail below), has increased the need for racing to promote itself as a betting product and incur additional costs in so doing, in order to maintain its position as a key betting property. However, bookmakers and other betting operators

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<sup>42</sup> The impact of simply maintaining the status quo in relation to prize money will, in our view, give other nations and their racing industries a competitive advantage at the expense of the reputation and standing of British racing. In turn, this may result in further significant and continuing withdrawals of investment in all parts of racing by owners who even at present levels of prize money recoup on average only 24% of the annual costs of keep and training, (i.e. excluding the capital cost of buying horses). The extent of the damage this would cause has not been modelled in recent years, but the British Horseracing Board's exercise in 1998 demonstrated that increases in investment on the scale set out in the BHB's Financial Plan would lead to over 3,000 more horses in training, with the resultant increased economic activity, more betting revenue and enhanced taxation revenue.

are currently under no compulsion to incur any marketing spend at all on the sport with which they share a special relationship, British racing. Indeed, although we have no accurate information from the betting industry on this issue, it appears that advertising spend consistently focuses on promoting other forms of betting (such as Ladbrokes' current football themed TV advertising campaign at a reported cost of £5 million).

- (iii) In a different commercial or sporting environment, the purchaser of rights works with the sport involved to develop an agreed promotional plan in order to raise the profile of that sport to the benefit of both. There is no reason why racing and the betting industry should not work together on a similar basis. The betting industry needs racing to do well and it benefits racing if the betting industry is wholly committed to the sport's well being. The agreement between 49 racecourses and the Attheraces consortium<sup>43</sup>, is a relevant example of how such a contract would be structured in a purely commercial context, albeit that the business plan underlying that contract was ultimately not successful.

- (b) The result is substantial increased costs to racing:

Starting in 2000, the Levy Board, with the support of British Horseracing, invested £10 million into a three-year marketing plan to drive attendances at race meetings and betting on racing. This budget far exceeded the aggregated additional marketing payments made by bookmakers and is strong evidence of racing's willingness to invest to the benefit of both the sport and its key commercial partner. The plan was delivered by the British Horseracing Board's marketing department under the guidance of the Group and, within 2 years, attendances and betting on racing (the latter as evidenced by a record levy yield) were at an all time high. However, due to the significant increases in the challenges faced by racing (as highlighted elsewhere in this Section 3.1)<sup>44</sup>, racing cannot afford to continue to so invest without other key areas suffering.

Promoting the sport of racing (and therefore, either directly or indirectly, betting on racing) is a core function of the Authority. Central promotional expenditure is now some £700,000 a year, which cannot be considered an adequate sum for the marketing and development of the sport. Our case is that the needs level is similar to the previous plan, indicating a need of, at the very minimum, £3.3 million more than current levels.

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<sup>43</sup> As described elsewhere in this document.

<sup>44</sup> Together with the fact that because the central marketing activities in this area were severely curtailed following the ECJ ruling in 2004 and the loss of the sport's main commercial income streams from non-GB betting operators.

- (c) Therefore, racing needs these increased costs to be met from an increased return through the Levy:
- (i) Against this background, and in order to preserve and improve the position of racing, racing's contention is that the Levy scheme should provide specific and significant funding for significant promotional activity for racing and betting on racing<sup>45</sup>.
- (ii) Given that the betting industry is effectively racing's promotional agent, the most effective way for this to take place is for a joint project between the two industries. The introduction of a specific marketing levy would enable the development of a proper business relationship between racing and betting. Racing believes that the reintroduction of a levy for promotional purposes would benefit both parties<sup>46</sup>.
- (iii) In order to counter this conclusion racing would have to divert funds from other important areas in order to meet these additional costs. To do so would simply lead to a decline in standards elsewhere in racing, leading the sport to wither.
- (iv) It follows that, in order to satisfy the purposes of the Levy to improve and advance racing, the Levy scheme should address specific marketing and promotional needs.

### **3.1.5 Veterinary Science, Education and Welfare**

**Summary: Racing continues to require significant investment for veterinary science and education. British racing is a leader in this field and needs to ensure that existing levels of research, development and welfare are maintained or improved to meet the challenges of the modern environment.**

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<sup>45</sup> It is worth noting that were the relationship between racing and the bookmakers to be a traditional "commercial" arrangement, it would be inevitable that the bookmakers would have significant marketing obligations to racing. By way of example, the marketing commitments entered into by Go Racing/Attheraces with the Racecourse Association under their media rights arrangement were significant. The guaranteed licence fee amounted to a minimum of £320 million, but in addition Go Racing/Attheraces committed itself to spending at least £80 million during the 10-year term on "marketing and promoting the rights granted and/or horseracing".

Similarly, when entering into a media rights agreement with the England & Wales Cricket Board in 1998, Channel 4 are reported to have agreed to invest £13 million in marketing and promoting cricket - the campaigns launched included creative marketing, special themed music festivals based on the culture of visiting Test sides and other events designed to promote the game.

<sup>46</sup> There is precedent in the Levy Scheme for a specific levy to be raised on the marketing of racing where a specific sum per betting office was used for promotional initiatives overseen by the Racing and Betting Marketing Group, a joint team of racing and betting appointees. Although accurate data recording the sums raised through this additional levy is difficult to source, the 39<sup>th</sup> Scheme was forecast to raise some £1.9 million in this way. The 40<sup>th</sup> Scheme raised £1.8 million, plus an additional £0.5 million contributed on a voluntary basis between Coral, Ladbrokes and William Hill. The additional marketing payment was not part of the 41<sup>st</sup> and subsequent schemes.

- (a) The need to maintain excellence is of paramount importance.
- (i) Racing's expenditure on veterinary science, education and welfare is a key core component of its commitment to self-improvement. Investing significant resources into veterinary research has long been a key priority for both the regulatory authority of racing as well as the HBLB.
- (ii) Racing also spends a substantial sum on provision for retired racehorses. Every sector of the sport makes a mandatory contribution towards this important item of expenditure, although only certain sectors of the betting industry make a contribution as they do so on a voluntary basis.
- (iii) Racing has also led the equine world in its response to the outbreak of Foot and Mouth Disease, first in 2001 and again in 2007. This investment in time and resources enabled the sport to continue in 2001, bringing substantial benefit to the betting industry. There are major threats posed by disease such as EIA and West Nile Virus. These would stop racing.
- (b) Therefore, racing needs these increased costs to be met from an increased return through the Levy:
- (i) It follows that in our submission, current Levy amounts are inadequate and additional investment must be made in order to meet the costs of maintaining and improving the standards of racing.
- (ii) Racing can ill afford to divert investment from other areas in order to meet these additional costs. To do so would simply lead to a decline in standards elsewhere. It follows that, in order to satisfy the purposes of the Levy, the funding to be made available to racing for veterinary science, education and welfare must increase to take into account increased costs.

### **3.1.6 Stable Staff, Lifestyle and Welfare**

**Summary: Racing continues to require significant investment in stable staff lifestyle and welfare. The Levy must be such as to meet increased demands in these areas.**

In other areas, racing's cost base has increased significantly due to the development of strategic initiatives. A report initiated by the British Horseracing Board to ensure that stable staff are sufficiently motivated, and recruited and retained in sufficient number, will lead to longer term investment in pay and conditions. This will act as a further call on racing's resources and, while it is accepted completely that this is the responsibility of racing as the employer, one of the key reasons for improvement being necessary is the increased demand made of staff through more fixtures at unsocial hours, the most recent example being the introduction of winter evening fixtures in betting industry-friendly slots. In addition, one of the key pillars of the investment programme in educating stable staff is about the risks associated

with betting and in fraternising with undesirable individuals. Again, this will bring benefit to the betting industry but is not reflected in any joint promotional initiatives or financial contribution.

The sport has conducted a thorough review of Lifestyle and Welfare provision, with an estimated total cost of in the region of £8-£10 million at its highest. This work remains to be done, pending the identification of funding.

### **3.1.7 Conclusion as to needs**

- (a) The Authority has been established as a "fit for purpose" governing body. Sports are encouraged, if not required, by Government to adopt best practice regarding strategy, planning and budgeting. At present, the operation of the Levy works against this. Racing wants to create a 3/5 year plan, which will address objectives and seeking efficiencies on a sound footing.
- (b) The Authority's analysis thus far has confirmed that, without a significant increase in the Levy amount in "real terms", there will be significant funding shortfall to racing<sup>47</sup>. If racing is to address the additional challenges and costs highlighted above, it will need to divert funding from its existing cost centres. The resulting "squeeze" will inevitably lead to a period of decline within racing and the benefits that it provides to Britain (economic, social and cultural) will wither. As we have identified, the Levy should be set at an amount which allows racing to thrive. Therefore, in our submission, the Determination must result in a significantly increased Levy Scheme in order to meet racing's needs/cost requirement.
- (c) We have identified that racing has incurred, and continues to incur, significant additional costs due to its relationship with the betting industry. Racing is carrying the risk of creating and improving content and product, at considerable and increasing operating cost, but not sharing in its true value to betting operators. The Levy must establish reasonable sharing of value. It is not reasonable to expect racing to continue to create, protect and improve the quality of its product without this.

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<sup>47</sup>Whilst in the past, and in a buoyant economy, racing has been able to absorb a certain level of funding reductions by increasing administrative efficiency and reducing its cost base, any form of effective "real terms" reduction in the Levy will have a direct and immediate effect on racing's ability to sustain the benefits referred to in Section 1 above.

### **3.2 BETTING OPERATOR ISSUES/CAPACITY TO PAY**

In this Determination, Racing's case is that betting operators are experiencing substantial growth in turnover and profit. The "capacity to pay" is hugely increased since 2002. We set out our view on these issues from publicly available information. Analysis of detailed business plans and full data by the Secretary of State will reveal the full truth.

#### **3.2.1 The betting industry's success - it has built a diversified, thriving business, rooted in its special relationship with racing**

**Summary:** In the period since 2002, bookmakers have enhanced and diversified their businesses, and benefited from cost saving opportunities - bookmaker and exchange turnover and profit have dramatically increased.

- (a) The betting industry is thriving and its market is diversifying: Since the most recent Levy Scheme Determination in 2002, it is clear that, when their entire businesses are considered, the betting operator/bookmaking industry is thriving.
- (b) There are a number of reasons for this, including:
- The positive impact of the gross profits based levy and betting tax: The Gross Win of the 2 largest bookmakers has grown from £1.4 billion in 2003, the first full year of gross profits based levy and betting tax, to £1.8 billion in 2006, representing 8% year on year growth through the period.
  - Expansion of betting exchanges: The gross profits of the dominant betting exchange have increased by on average 111% per annum in the 4 years from April 2002, moving from £5 million to £108.8 million during the period.
  - The development of online betting propositions: Including moves of previously UK based bookmaking operations offshore to non-levy paying jurisdictions: these include Victor Chandler and Stan James.
  - The diversification of in-shop gambling opportunities: In particular the actual and predicted growth and relative significance of Fixed Odds Betting Terminals ("FOBTs"), on which gross win has risen from zero in 2001 to an estimated £600 million for the main 3 companies in 2007.
  - Bookmaker profits from overseas racing not being subject to the Levy: This change of policy has reduced the Levy by at least £3 million per annum.

- (c) The table below sets out the compound annual growth rate in bookmakers' turnover (CAGR) for both the period 2001–2006 and for 2003–2006 and also the percentage increase in turnover for the same periods<sup>48</sup>.

<b>Bookmaker</b>	<b>CAGR 2001-2006</b>	<b>CAGR 2003-2006</b>	<b>Increase in Turnover 2001-2006</b>	<b>Increase in Turnover 2003-2006</b>
Betfred	37.2%	32.0%	387%	130%
Coral		26.6%		103%
Ladbrokes	36.4%	19.4%	372%	70%
Tote	47.3%	50.6%	594%	242%
William Hill	40.1%	30.6%	440%	123%
Weighted Average	38.7%	26.1%	413%	101%

- (d) The increases in turnover shown above are significant. Any business that has increased compound annual turnover by over 20% over a period of time is likely to have exceeded general economic growth. By way of useful comparison, revenue growth for the 295 companies that have been in the FTSE 350 throughout the period 2001 to 2006 averaged 7.6% over this five year period. This clearly shows that the sustained growth of the bookmakers is far exceeding current market norms.
- (e) Although information on the breakdown of turnover is not publicly available, FOBTs have been a significant contributor towards this increase due to their small gross margin and the recycling that they impact on an initial stake. According to the Tote, FOBTs business experienced 31% growth in 2005-6 and 20% the previous year.
- (f) Whilst turnover is a useful measure, another key metric is gross win. Only two of the bookmakers analysed released gross win figures to the public between 2001 and 2006, Ladbrokes and William Hill. These results are aggregated below:

<sup>48</sup> Two comparison periods have been used for two reasons: (i) information for the period 2001 and 2002 is not publicly available for all bookmakers; and (ii) as mentioned elsewhere in this document, the taxation system was changed in October 2001 from a turnover tax to a gross profits tax, followed in April 2002 by a similar change to the basis of calculation for Levy payments. The figures set out in this section comprise bookmaker turnover from Britain and Eire combined. No separate and complete figures are available for Britain alone.

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Turnover	5,073	7,178	13,213	18,410	22,246	25,619
Gross Win	1,076	1,147	1,403	1,592	1,647	1,781
Gross win %	21.2%	16.0%	10.6%	8.6%	7.4%	7.0%

- (g) Analysis of these results shows that although bookmakers' gross win continues to increase at a significant rate, there has been a significant decrease in gross win percentage over the period. This is due to a change in product mix, with the majority of the turnover growth noted above being in lower gross margin FOBTs. This has had a negative impact on racing because racing has been providing more product to the betting industry but at the same time has experienced a loss of market share which has meant that there has been no increase in return to racing through the Levy on a commensurate basis.
- (h) Over the period shown above gross win has compound annual growth of 10.6% and grew by 66% in real terms. This compares to growth in turnover over the same period of 38.2% and 505%. In short, the bookmakers have been remarkably successful in financial terms in the last few years.
- (i) The following table shows the proportion of gross win contributed by retail (i.e. betting shops) and non-retail platforms<sup>49</sup>:

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Gross win - Retail	85.5%	82.0%	81.9%	79.8%	79.4%	77.7%
Gross win - Non retail	14.5%	18.0%	18.1%	20.2%	20.6%	22.3%

This shows a gradual move from retail to non-retail. This is in line with expectations and has no impact on bookmakers' overall capacity to pay. It shows only that bookmakers are less reliant upon shops for revenue and profits than they used to be.

- (j) Again FOBT growth and contribution to gross win is key to understanding the above figures. Both Ladbrokes and William Hill provide this information publicly and it is therefore possible to see the relative importance of FOBTs for bookmakers.

<sup>49</sup> This information is from William Hill and Ladbrokes only.

	2004	2005	2006
	£m	£m	£m
Gross win	1,592	1,647	1,781
Gross win - retail	1,270	1,307	1,384
FOBT Gross win	319	373	411
FOBT contribution to Gross win	20.1%	22.7%	23.1%
FOBT contribution to retail	25.1%	28.6%	29.7%

(k) The table below sets out total Levy receipts across a 6-year period and provides a useful contrast to the above<sup>50</sup>.

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	£m	£m	£m	£m	£m	£m
Levy receipts	72.9	79.9	110.7	105.6	99.3	98.7

The decline in Levy return since 2003/4 is in stark contrast to steady increase in total gross win of the major bookmakers at the same time.

- (l) The annual compound growth of the Levy from 2001/02 to 2006/07 is 6.2% and from 2003/04 – 2006/07 a reduction of 3.8%. This can be compared with the compound annual growth in betting operator gross win over the same period of 10.6%<sup>51</sup>. Another useful comparison is that whereas in real terms betting operator gross win has increased by 66% from 2001 to 2006, their levy payments have only increased by 35% over the same period<sup>52</sup>.
- (m) Even excluding FOBTs from William Hill's and Ladbrokes' gross win, their gross win has increased by 7.7% over the two year period from 2004 to 2006. This contrasts with levy payments over the same period, which have decreased.
- (n) The betting industry is therefore in a position to meet an increased return through the Levy, and it is fair reasonable to require it to do so: As yet, the bookmakers' successes have not been reflected in a corresponding return to racing. It is important that these broader economic factors be taken into account in determining the proper return which racing should receive from the betting industry via the Levy.

### **3.2.2 Assessing the bookmakers' capacity to pay**

**Summary: In determining the bookmakers' capacity to pay (and contrary to the assertions of the bookmakers) there is no basis in law to**

<sup>50</sup> These figures include contributions from the Tote over the period.

<sup>51</sup> As highlighted in this Section 3.2 above.

<sup>52</sup> As highlighted in this Section 3.2 above.

**suggest that, in making his assessment, the Secretary of State is restricted to considering those revenues which bookmakers derive directly from their British horseracing business.**

**Instead, he must make an informed decision, taking into account the prevailing economic condition and other “fiscal, social and economic” circumstances, and must arrive at a fair and reasonable Levy when analysing “needs” and “capacity to pay”.**

- (a) The bookmakers favour a narrow approach. The Bookmakers' Committee has argued that it is inappropriate to take non-horseracing betting income into account when assessing the capacity of a bookmaker to pay the horserace betting levy. The bookmakers cite the OCP Report in supporting their argument. Racing strongly disagrees with this assertion.
- (b) The Secretary of State is obliged, in exercising his discretion as to the amount of the Levy, to make an informed decision which takes proper account of all the circumstances. We have established that it is the clear aim of the legislation<sup>53</sup> that the Secretary of State should properly have regard to the prevailing economic conditions and other "fiscal, social and economic" considerations when making his Determination. It follows that it would be counter-intuitive to take a narrow, restricted view of any part of that Determination, including consideration of bookmakers' "capacity to pay". Therefore, consideration should be given to the whole of the bookmakers' businesses<sup>54</sup>. This requires an assessment of the wider revenues from the bookmakers' entire operation (i.e. including revenues made from FOBTs/amusement with prizes machines in their shops, profits made from the Irish lottery, other sports betting etc), which, as we will establish below, are achieved as a result of the betting industry's historical symbiosis with the horseracing, and so are directly related to betting on horseracing.
- (c) Racing contends that the transition, in 2002, to a gross profits-based Levy scheme had the effect of diminishing any argument by the Bookmakers' Committee that they do not have the capacity to pay an increased Levy. This is because there is an inherent link between gross profit and ability to pay. If gross profit exists, there is, self evidently, a capacity to pay.

This view is supported by the comments by the Promoter of the 1969 Act:

- Much of the discussion of the meaning of "capacity to pay" was, unsurprisingly, conducted in the context of the removal of the "Need/ Capacity to Pay Test" from the statute book in 1969. Several opposition MPs were concerned that, if the test were to be removed,

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<sup>53</sup> When read, as it should be, in the context of interpretative comments made by Secretaries of State and the Promoters of such legislation.

<sup>54</sup> See Section 2.3.

the bookmaking industry would lose a valuable protection with the net effect that they could conceivably be asked to pay beyond their means. Government was reassured that the bookmaking industry was not really subject to this danger when the levy was based on gross profits, rather than turnover. The Promoter of the 1969 Act highlighted the issue: *"this question must be asked: what part of their resources is it within their capacity to pay? According to the strict, grammatical interpretation of the words, if they are allowed to retain no more than enough to maintain themselves and their families at subsistence level, then, strictly speaking, they are capable of paying the remainder, after tax and duty, to the levy. That is the strict and proper interpretation of the [capacity to pay test]."*

- The Promoter continued by commenting that *"a tax on profit has at least one advantage: the capacity to pay is fairly easy to construe. Any court can have some regard to the amount of profit which has been made and a judge can take into consideration what appears to be a reasonable amount which should be abstracted in levy."* (Horseracing Betting Levy Bill 1969 - 5 March 1969, 573).

By implication, a large degree of the protection afforded to the bookmakers by the capacity to pay test was considered to be achieved by moving to a gross-profits based levy, thus diminishing any argument that the bookmakers do not have the capacity to pay an increased Levy.

- When announcing the move to a gross-profits based levy in the 41st Levy Scheme, the same link between a gross profits based approach and "capacity to pay" was emphasised by the Secretary of State: *"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"* (Tessa Jowell MP, 29 January 2002, ministerial statement upon announcement of the 41st Levy Scheme).
- One of the reasons given for the shift, in relation to the 41st Levy Scheme, from a turnover to gross profits-based Levy scheme, was that this would mirror the change in approach taken in relation to the tax paid by bookmakers to the Inland Revenue. When considering the "turnover vs gross profits" arguments in relation to the tax payable to the Inland Revenue, the Government provided further acknowledgement of the fact that a gross-profits based Levy inherently takes due account of the bookmakers' ability to pay,

reasoning that a tax on bookmakers' gross profits would "*be more efficient, taking into account a businesses ability to pay*"<sup>55</sup>.

- (d) The argument for a narrow approach, whether or not correct in 2002 (and we would submit it was incorrect then), is no longer viable.

If the relevant legislation and the Schemes had intended the narrow definition, it would have said so. It actually states the contrary<sup>56</sup>. We would also refer to the reference by Richard Caborn on 14 December 2006 to the "prevailing economic position" as support.

We also contend that it is wrong to say that simply because the product of the Determination is a Levy on bets on horseracing, then the assessment of capacity to pay is also restricted to bets on horseracing. That is patently not the case.

- (e) Our case is strengthened by the existence of the special relationship between racing and the betting industry. Because the wider business of the betting industry is driven by and therefore is directly related to British horseracing that wider business should be taken into account when assessing the bookmakers' capacity to pay. Several factors support this analysis:

- (i) Licensed betting premises only exist because of racing's support

Horseracing supported the idea that off-course bookmakers be legalised via the Betting and Gaming Act 1960, but only on the basis that horseracing also benefited. Support from horseracing for the legalisation of off-course betting: "*we must remember that the price paid for the support of the Jockey Club for the proposal to license and legalise betting shops was the promise to introduce the levy.*"<sup>57</sup>

Similarly: "*It is too readily forgotten that the betting levy was one feature of a new dispensation which included others of great benefit to the bookmakers, in particular, the right to establish betting offices.*"<sup>58</sup>

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<sup>55</sup>As noted in a Memorandum From The Economic Secretary To The Treasury On The Gambling Bill And Taxation - 8th January 2004.

<sup>56</sup> When read, as it should be, in the context of interpretative comments made by Secretaries of State and the Promoters of such legislation.

<sup>57</sup> Per Mr Fletcher (Introduction of the Peppiatt Report to the House of Commons - 23 May 1960, 88).

<sup>58</sup> Per Mr Elystan Morgan (the promoter of the Bill), in relation to the Horseracing Betting Levy Bill 1969.

- (ii) Betting market diversification was only ever permitted as a consequence of racing's support. As such its capacity to pay the Levy should take account of all activities operated by a bookmaker.

There are many examples of circumstances where racing, cognisant of the profits available in certain of diversified products which the bookmakers wished to make available, have supported diversification (which sometimes required a relaxation of legislation) on the basis that it would increase bookmakers' capacity to pay and therefore have a positive impact upon the amount of the Levy:

- In the 1990s, Racing did not oppose the introduction of AWP machines on the basis that it would help to support betting offices which were operating at the margins and thus ensure that they would continue to be able to contribute to the levy.
- In relation to the diversification of bookmakers' businesses to include gaming machines Viscount Falkland stated: *"I am very glad to see that the orders mention the compulsion that there will be for bookmakers ultimately to pay their dues to the Levy Board. That did not exist in the same form previously. I refer to the profits from machines in betting shops. They are there expressly as part of the horseracing industry and were created for that purpose. Incidentally, it was for that reason that the Irish Government decided not to have machines in betting shops. They thought that it was inconsistent with the aims of betting shops to be part of the racing industry and declared that gaming machines were no part of the racing industry."* Viscount Falkland, House of Lords Grand Committee (10 July 2007), debating the coming into force of several Gambling Act-related statutory instruments.

- (iii) Bookmakers' businesses, both related to horseracing and otherwise, have benefited from the relaxation of restrictions on the opening hours available to betting shops. Such relaxations are attributable, in large part, to racing.

Without the availability of evening horseracing products (organised at the cost of racing) restrictions on bookmakers' opening hours would not have been relaxed in the way that they have been:

Weekday opening hours for betting shops were extended by the Licensed Betting Regulations 1986 SI 1986/103 (as amended by the Licensed Betting Offices (Amendment) Regulations 1993 SI 1993/51). When deciding to allow betting offices to remain open until 10pm from April to August, the then Home Secretary stated that *"the growth in the number of evening horseraces has created increased consumer demand for evening opening of licensed betting offices during the*

*summer months.*" Indeed the justification for opting for 10pm rather than 9pm appeared to be solely that "*some horseraces are run after 9pm and [we must] allow time for payment of winnings*"<sup>59</sup>.

Therefore, racing has provided the justification for bookmakers to remain open when they would otherwise not be, and so has enabled bookmakers to generate additional revenues (both in relation to those races, and also by providing a greater opportunity for punters to bet on other sports and, more recently, use FOBTs).

For racing to enable this extension of the bookmakers revenue streams, but not to participate in the resulting benefits, would be illogical.

A further example of a relaxation in opening time restrictions is provided by The Deregulation and Contracting Out Act 1994 (at Section 20). This amended the Betting, Gaming and Lotteries Act 1963 so as to permit betting offices to open on Sundays.

Racing supported this relaxation of the law (exemplified by Mr Ian Taylor, MP for Esher, confirming on 10 May 1994 the support of Sandown Park). As the majority of the Commons debate centred around the impact of the relaxation on betting shops and horseracing it would appear likely that had racing vehemently opposed the change then it may well not have occurred. For example, mention was made of the "*concern of the Stable Lads Association*", but Parliament took comfort in the fact that "*the British Horseracing Board will undertake to initiate discussions with employers to obtain appropriate improvements and changes to the terms and conditions that will be necessary for stable lads who will have to work longer hours and on some Sundays*".

Indeed, one reason given by racing for its support of the relaxation was that "*over time it would boost the viability and prosperity of horse racing ... the crucial ingredient [being] ... the levy*" (per John Greenway, in Parliamentary debate on 10 May 1994).

- (iv) Horseracing also supported the bookmakers in their desire to make betting shops more attractive places for punters, with the inevitable consequence that more people would visit/remain on site, and betting on racing would increase.

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<sup>59</sup> Schedule 5 Part 2 of the Gambling Act 2005 (Mandatory and Default Conditions) England and Wales) Regulations 2007 SI 2007/1409 has now confirmed that the default restrictions on opening hours are that no facilities for gambling are to be made available on site between 10pm and 7am (all year round), however these may be varied by the relevant issuing authority (which is a district, county or London borough council).

The support, or non-opposition, of horseracing, was a major factor in the relaxation of the rules governing the conduct of business within betting shops. For example, the Betting, Gaming and Lotteries Act 1963 (Schedule 4) Amendment Order 1986 allowed bookmakers to, inter alia, install television sets into their licensed betting offices. During its passage through the House of Lords Viscount Davidson commented that "*We have taken comfort in our approach from the fact that the sport concerned has stopped short of seeking to oppose the order and our consultations have revealed a general acceptance that it would be right to introduce a measure of deregulation in the present (and now outdated) rules which apply to the facilities in betting shops.*" (Hansard pre-the Betting, Gaming and Lotteries Act 1963 Order 1985, 19 December 1985).

(v) Increased FOBT business is linked to the provision of racing product eg: winter evening racing

The connection between FOBT business and racing has been made clear by recent betting operator announcements such as the Tote and Ladbrokes:

- As we have noted elsewhere, in response to bookmaker demands, the fixture list has been expanded by over 18%, from 1,270 fixtures in 2003 to a published list of 1,504 fixtures in 2008. Whilst the betting opportunities provided by the additional fixtures increase bookmakers profits in and of themselves, the existence of such fixtures increase profits on other products available in betting shops.
- The introduction of winter evening fixtures in 2007 is one example of racing incurring the cost of staging additional fixtures, but without any guarantee of an appropriate financial return from these additional "betting-friendly" opportunities. It is anticipated that a significant benefit of these fixtures will actually accrue to the betting industry through the greater use being made of FOBTs. For racing to incur costs, but not participate in the resulting benefits would be illogical and this provides further evidence that a consideration of the bookmakers' capacity to pay should also include consideration of the bookmakers' revenues which derive other than directly from horseracing.
- Full examination of the true extent of this will only be possible through determination by the Secretary of State and the provision of full information by betting operators.

- (vi) Research has demonstrated that horseracing creates a "lure", which draws people into bookmakers and into participating in "secondary" betting on other products

Racing is a vitally important part of the offering provided by betting operators. In Licensed Betting Offices, from where 75% of the Levy yield derives, the horserace betting product is now only one of a number of products which are promoted by the betting industry. However, it is the product which continues to represent the bedrock of the betting industry's core business and from which the rest of the betting industry's profitability flows:

- British racing is the key driver of betting office traffic for 63% of users of FOBTs in betting shops (TNS survey for the BHA, September 2007).
- Horseracing continues to be "the dominant betting shop product" (Ladbrokes Annual Report 2006).

- (vii) Interest in placing bets is initially created by horseracing, and so, even if the actual bet placed is not actually on a horserace (e.g. on a simulated race or any other offering) it should not have a negative impact upon the bookmakers' capacity to pay, and hence should not have a negative impact upon the money received by horseracing.

The Gaming Act 1968 s.34 allows amusement with prizes machines in licensed premises. In supporting the creation of the Act, Arthur Davidson (Labour MP) said "*when the foot and mouth epidemic recently stopped horse-racing people got such itchy fingers after a week or so that they found themselves betting on computer racing*" (Hansard - 13 February 1968).

### 3.2.3 Betting Exchanges

**Betting exchanges require separate consideration under the 47<sup>th</sup> Scheme. Due to their different business model, betting exchanges cannot be treated in the same way as traditional bookmakers for Levy calculation purposes. Racing does not accept that the exchange market should be assessed on the same basis as traditional bookmakers (i.e. gross profit of the exchange itself).**

**Exchanges were still a relative newcomer when the 41<sup>st</sup> Scheme was determined and the current approach to profit made on bets via exchanges is no longer fit for purpose. The levy mechanism must be amended to create an equitable solution which remedies the current lacuna, ensuring a fair levy return relating to every pound staked, irrespective of whether that is with a licensed bookmaker or via an exchange.**

#### a) **The bookmakers' contention**

- (i) The bookmakers have, in their recommendations dated 2 October 2007, proposed that exchanges should be assessed on the same basis as traditional bookmakers (i.e. based upon their gross profits).
- (ii) Although the Bookmakers' Committee confirmed that the majority of its members consider that those laying bets via exchanges should be viewed as bookmakers the recommendation made by the Committee is that the only applicable levy payment is that to be made by the exchange operators, and this should remain based upon their gross profits.
- (iii) It is not credible for the Committee to have failed to address exchanges and their contribution to racing through the Levy. We also believe that the reasons why this group has failed to address this issue is worthy of further examination by the Levy Board or DCMS because it is arguably failing in its statutory duty.

#### b) **The inherent problem with the approach advocated by the bookmakers**

**As betting exchanges increase in popularity, an increasing number of otherwise "leviable" bets are conducted in an environment in which, under the current regime, racing does not share properly in a fair and reasonable way. The problem is getting worse.**

**The effect of the current regime, which the bookmakers argue should be retained, is to reduce the profits from bets made by and via exchanges which are subject to the Levy.**

- (i) Exchanges earn money by charging commission, typically at between 2% and 5%, on the profit made either by the layer or punter; the smaller the layer

or punter, the higher the rate of commission charged by the exchange. This means that a small recreational layer winning £100 has a £5 commission deducted by the exchange, on which the exchange currently pays betting tax at 15% (75p) and the Levy at 10% (50p). It should be noted that larger layers will incur significantly smaller commissions - where commission amounts to only 2%, the betting tax and levy paid on that same £100 win would amount to just 30p and 20p respectively.

In contrast, a licensed bookmaker winning £100 is charged 15% betting tax (£15) and 10% levy (£10) on the lost bet placed by the punter. However, it is not as simple as saying that exchanges should pay twenty times more than they do currently - this is because commission is earned (and levy paid) by exchanges not only on winning lays, but also losing lays (i.e. winning bets). The analysis later in this section proposes a solution to address this.

Under the present Levy system, which as set out above the bookmakers are advocating should remain in place, the successful layer does not have any obligation to make a payment to the Levy.

- (ii) The increased popularity and prevalence of betting exchanges has led to a situation whereby a significant number of people who previously placed bets via traditional bookmakers, whose profits are subject to the Levy, instead place them, via exchanges, with unlicensed layers - whose profits are not currently subject to the Levy.
- (iii) The effect of the current Scheme is that it creates a "Levy Lacuna". Although the operators of exchanges are (as set out in paragraph 1 above) required to make levy contributions, these are based only on the commission earned, which is a small percentage of the profits made by those actually laying the bets. This means that as exchanges become more popular and capture a greater market share an increasing number of layers and profits that are no longer subject to a full Levy contribution; the "Levy Lacuna" become wider.
- (iv) Racing is not against the principle of low margin exchange operators taking market share from traditional bookmakers, but we do oppose them being advantaged in this process at the expense of racing by allowing an unfair system to work in their favour.
- (v) One of the primary intentions of the move in 2002/2003 to a gross profit rather than turnover-based taxation and Levy assessment was that "*both the betting and racing industries [would] share in the benefits*". Betting exchanges, together with those who use their facilities, have benefited from these changes, as layers can set odds impervious to the requirement to pay 10% Levy and 15% Gross Profits Tax. This allows the layers to set more attractive odds to the punter and hence drive traffic away from the traditional platforms, increasing the exchanges popularity. However, there has been no equitable sharing of this benefit with the industry which has formed the bedrock for their business, racing.

- (vi) The outdated and inequitable nature of the current levy charge on exchanges is illustrated particularly vividly in the ability of exchanges to offer discounted (or even zero) commission rate deals to high staking/new layers and punters. As advertised in the Racing Post, the exchange WBX charged only 1% commission on all bets laid on 18<sup>th</sup> and 19<sup>th</sup> November 2007. Betfair's own website outlines how a commission rate is set for any individual customer, starting at 5% but decreasing to 2% for high value users. Therefore, the profits of exchanges which are subject to the Levy do not necessarily reflect (even on a reduced percentage basis) the amount of profit being made by those people laying bets via their services which, if laid by a licensed bookmaker, would be subject to Levy and Gross Profits Tax at the full rate.
- (vii) As recognised by the Bookmakers' Committee in relation to the 42nd Scheme, racing should not suffer as a result of the adaptation of a new business model which itself is sustained by racing. The approach of the current Levy Scheme to profits on bets made by and via exchanges is no longer fit for purpose and the levy mechanism must to be amended to create a more equitable solution.

c) **The extent of that inherent problem**<sup>60</sup>

- (i) **The problem of the "Levy Lacuna" highlighted above has become more concerning as betting exchanges grow in popularity.**

Whilst turnover growth from the 2001 changes in the betting taxation was predicted, the exponential rise in betting exchange business, and its associated negative impact on the levy system, was not. As at April 2002, the current dominant exchange, Betfair, had been operating for less than two years and its turnover was a relatively modest £6.1 million per annum. Some 4 years later, annual turnover had reached £145 million, representing average annual growth of 120%. We contend that the Determination of the 41<sup>st</sup> Scheme and then the settlement of the 42<sup>nd</sup> and subsequent Schemes has not taken proper account of increased activity of this order.

- (ii) We estimate that in 2004/05 (the last year for which we have robust bookmaker information) £8.2 billion of bets placed on British racing through traditional betting operators produced £1 billion in margin, £7.2 billion in returns to punters (net winnings) and £99.7 million in Levy. This means that the Levy collected from bookmakers equates to 9.84% of gross profits, 1.20% of turnover and 1.38% of net winnings.

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<sup>60</sup> The calculations in this section are based on the following assumptions: (a) average commission rates on betting exchanges are the same in both 2003/04 and 2004/05; (b) the big 5 bookmakers make Levy contributions at 10% of gross profits, and all other bookmakers using a contribution rate of 9.25% in both years; (c) independent bookmakers gross profit margins being 12.5% and 10.2% in 2003/04 and 2004/05 based upon a sample of 20% and 15% of independent bookmaker's annual statements in each year respectively; and (d) On course bookmakers Levy payments of £0.6 million (04/05) and £1.4 million (03/04) are excluded from the analysis.

- (iii) In contrast, we estimate that in 2004/05, Betfair, whose figures are publicly available and who are the largest betting exchange so are likely to be representative of the market, made a £5.2 million Levy contribution. Based upon the Levy amounting to 10% of gross profits, this implies horserace commissions of £52 million. Working on the basis that those laying bets pay an average commission rate of 3.5% (commission rates fluctuate between 2% and 5% - source: The Funding Question) to Betfair, this would suggest that the net winnings of those who lay bets via exchanges amounts to £1.5 billion.
- (iv) These calculations are set out in the table below:

Contributor	2004/05 Levy (£m)	% contbn	Net winnings £m	%	Levy as a % of net winnings
Traditional betting operators (inc Tote)	99.7	95%	7,236	83%	1.38%
Betfair	5.2	5%	1,486	17%	0.35%
Total	104.9	100%	8,722	100%	

- (v) Put simply, despite accounting for 17% of the market as measured by returns to punters (which number is depressed by allowing netting for betting exchange customers on single markets), betting exchanges contributed only 5% of the Levy charge. A charge on exchanges equivalent to 1.38% of customers' net winnings would bring the contribution generated by the betting exchanges in line with their level of betting activity. This is only one of many methods by which the charge could be calculated, but has the simplicity of matching the exchanges' own charging methods, recognises the unique feature of exchanges in allowing punters to back and lay the same outcome to a race several times and only pay levy on the net position, and is independent of the charge made by the exchange to the user of their site i.e. the commission rate.
- (vi) Betfair's market share has increased at a disproportionately higher rate than their Levy contribution. Their market share had grown by 3.8 percentage points whilst their contribution has grown by only 1.4 percentage points over the same period. This means that the 'contribution gap' between market share and product value has increased from a 9.6 percentage point shortfall to a 12 percentage point shortfall. Hence, despite only accounting for 83% of the market in 2004/05 traditional bookmakers still contributed 95% of the Levy.
- vii) If the gross win achieved by those laying bets via the major exchange was subject to Levy payments in the same way in as the gross profits of licensed bookmakers, the Levy contribution derived from Betfair users in the period

2004/2005 would have amount to a charge of 1.38% of £1.5 billion, or £20.5 million, nearly 4 times the actual figure paid by Betfair.

- (viii) The scale of the problem is increasing. In 2003/4, exchanges accounted for 13% of punters' total net winnings. Extrapolating this same analysis, using the actual contribution of exchanges to the 45<sup>th</sup> Levy Scheme 2006/07 and current HBLB forecasts, we estimate that, for the 47<sup>th</sup> Scheme 2008/09, betting exchanges will account for 21% of punters' total net winnings and would need to pay a total levy equivalent to 1.6% of punter's net winnings in order to achieve 'platform neutrality' for racing whereby activity in either the betting shop or on the exchange returns the same amount in Levy to the sport.

(d) **Racing's proposed solution**

**The proposals made by the bookmakers in relation to the 42nd Levy Scheme, as approved by the Levy Board, included provisions for Levy payments to be made by Exchanges in recognition of the profits made by those laying bets via the Exchanges.**

**As set out above, the Bookmakers' Committee submission in relation to the 47<sup>th</sup> Scheme does not address the issue, instead suggesting that exchanges should be assessed on the same basis as traditional bookmakers (i.e. gross profit). It is racing's contention that this issue must be addressed in order to achieve a fair and reasonable Scheme.**

- (i) Because the business model of exchanges is fundamentally different to that used by the more traditional licensed bookmaker, the methodology of the related Levy contribution must be considered separately. The significance of exchanges activity has not been independently considered since the Determination in 2002. It is clear that in moving forwards to a modernised Levy, exchanges must play a role reflective of the benefits which they now enjoy.
- (ii) In October 2002, the Bookmakers' Committee recommended a new approach to levy payments from betting exchanges for the then upcoming 42nd Scheme. Exchanges would continue to pay 10% of their gross profits (i.e. the commission received) but, in additions, they would pay a sum equal to 10% of gross profits from successful lays aggregated during the year.
- (iii) This Bookmakers' Committee's proposals in relation to the 42nd Scheme were approved by the Levy Board by six votes to two. However, the element of the Scheme which related to Exchanges and Spread Bettors was not implemented. The reason for this was that a judicial review of the process adopted in agreeing the Scheme found that such process had not included representation from the Exchanges on the Committee - in essence the exchanges were said not to have been consulted properly as to the proposed arrangements.

- (iv) The 42nd Scheme therefore operated, as have those subsequently, with Exchanges enjoying the same position as that of the traditional bookmaker, with the Levy contribution remaining as a percentage of their gross profits, not taking into account the underlying level of profits generated by those unlicensed layers, who currently make no levy contribution whatsoever.
- (v) Ultimately, it is unfair that levy payable should be dictated by commission charged by the agent matching punter and layer, rather than being directly linked to revenues deriving from the betting activity.
- (vi) Racing seeks a fair deal. We suggest that a fair deal is one that calculates the levy in direct relation to the bet placed between the two parties, not in relation to the commission taken by an agent in arranging the bet. We suggest a fair deal is, as far as possible, 'platform neutral' i.e. one betting pound delivers the same amount of levy irrespective of the platform upon or service via which the bet was placed, although we accept that some betting models, such as exchanges, are 'lower cost' than others. However, the current Levy Scheme has allowed exchanges to benefit from some 5 years of unprecedented growth through levy subsidisation and that this growth, brought about by the Gross Profits Levy and Gross Profits Tax models, has not seen the benefit shared fairly with racing.
- (vii) In determining the format of a robust and fair Levy charge, it is clear from the documentation around the judicial review of the 42nd Scheme that there are several potential models and, at that time, parties could not agree as to a fair formula. A basis for the methodology that is deemed fair to the exchanges is the commission model they themselves use, based upon punters' net winnings, the measure of activity on the site that is most easily compared to traditional bookmaker activity.
- (viii) We say that the exchange is not a bookmaker; it is a facilitator, putting layers in contact with punters. For this they collect a commission at a rate of their choosing. But the Levy Board seeks no Levy from the phone company that brings together bookmakers with phone customers, the ISP that lets punters bet over the internet, nor the racecourse that charges a daily fee to bookmakers to allow them to attend their pitch. As with all other forms of betting on horseracing, the levy should be a charge directly related to the betting activity.
- (ix) If the exchanges are bookmakers, then we question why they take deductions from punters, when the key proposition behind the gross profits tax and levy was to end such deductions. There is clear precedent for levy on betting operators to be set according to the specifics of their market - on course bookmakers no longer pay on the gross profits basis but pay a flat rate and a daily attendance fee.
- (x) It is argued by the supporters of exchanges that they are the perfect market and, given maximum liquidity provided by almost unlimited backers and

layers, profit margins will be forced down to equal the commission rates being charged by the exchange. Although this hypothetical situation takes no account of a backer or layer's desire to make a profit for themselves, i.e, their own motivation to participate, and at what point they would withdraw from participation, this principle again does not achieve, we contend, the sharing of the benefits envisaged by Government upon the introduction of Gross Profits Taxation and Levy.

- (xi) Taking all these factors into account, we propose that the levy payable by betting exchanges is set at 1.15% of punters' net winnings. This is below the 1.6% charge that would deliver a levy scheme that was fully platform neutral but is fair in recognising the new business model developed by the exchanges. The 1.15% charge would contribute £20 million to the 47th Levy Scheme and, if adopted, would allow the headline levy rates for traditional betting operators, based on gross win, to be reduced accordingly.

(e) **Conclusion – A Fair Deal from Exchanges**

Levy from Exchanges continues to grow. £5.2 million in 04/05, £5.4 million in 2005/06 and £6.1 million in 2006/07. For the reasons outlined above, this only exacerbates our problem. Exchanges continue to take market share away from the traditional platforms, assisted by a levy system that takes no proper account of the level's of exchange activity and allows the exchange themselves to set commission rates and hence rates of levy payments.

The Levy charge on the exchange, set at 1.15% of punters' net winnings, removes from the exchange operator the ability to control rates of levy payment, is simple to operate, and recognises the unique exchange model where by multiple transactions backing and laying the same outcome may be netted off against each other, yet makes a fair recognition of the low cost betting model developed by betting exchanges in their short eight year history.

### 3.2.4 Other Specific Issues

In our submission, the current Determination (together with any further more detailed investigation) should consider whether, and if so to what extent, certain betting operator revenue streams should be subject to the Scheme and not solely be taken as contributing to capacity to pay<sup>61</sup>. A fair and reasonable return to racing should include a return which recognises its contribution to these other revenue streams.

- (a) Overseas racing: We believe that there is a strong case for the reintroduction of a Levy charge on overseas racing products offered by bookmakers in licensed betting offices (as there was prior to 2003).

We note that the bookmakers have indicated their view that the Levy should not attach to gross profits generated by overseas racing<sup>62</sup>, but reject their arguments as to why this should be the case.

In particular, we do not accept that such a change would be "unlawful". The Levy is properly payable only by bookmakers who carry on a business which includes the "*effecting of betting transactions on horse races*" "*in respect of so much of the business of the bookmaker as relates to betting transactions on horse races*" (Section 3 of *The Betting Levy Act 1961 - as amended*), and as such it is entirely proper that bets placed on overseas races should be leviable. Indeed, this reflects the status quo until 2003, when the levy on the bookmakers' turnover/profit from overseas races was removed because, in 2003, the British Horseracing Board had in place data licences which, it was intended, would supersede the levy. Since the European Court of Justice's decision in 2004 has led to a position whereby data licences can no longer fulfil this levy-replacement function, racing is now in a position whereby it has lost the benefit both of the Levy on overseas racing products and also their supposed replacement. It follows that reinstatement of a Levy on such revenues would be entirely reasonable.

In this Determination, however, we do not propose the reintroduction of the Levy on overseas racing provided that the total outcome is fair and reasonable. It follows from our analysis above that this activity is in any event highly relevant to the capacity to pay analysis.

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<sup>61</sup> Racing's preferred approach in relation to revenues deriving from overseas racing, is that they should be viewed as separate leviable items and treated on a like for like basis with British racing. We consider that this approach would produce a fairer and more reasonable result than at present.

<sup>62</sup> They claim that this would be a "step backwards", and argue that any such move would be "unlawful". The bookmakers assertion is that they purchase overseas horseracing from third parties on a commercial basis (by which we assume that they mean the right to show races in their offices/use data etc), and they see "no justification whatsoever for benefit accruing to British racing through imposing a levy on a non-British racing product" (per the Recommendations by the Bookmakers Committee dated 2 October 2007)

- (b) Virtual racing: Although racing considers there to be a case for there to be a levy charge on virtual horseracing, we would not propose to argue this in the Determination but would simply include it in the analysis of capacity to pay.
- (c) On-course bookmakers: The flat rate payments made by On-course bookmakers under the Scheme leaves the Levy Board with no visibility of the profits generated by on-course bookmakers, and should be reviewed to ensure balanced treatment of all betting operators under the Scheme, and a fair return to racing.
- (d) Overseas bookmakers: Racing, the Levy Board and the Bookmakers' Committee (and its constituents) should together, in conjunction with the Gambling Commission and Government, address securing a return to racing from overseas betting operators who offer betting on British racing but are avoiding Levy. Racing's contention is that any bet on British racing which is offered and promoted to a British customer should, irrespective of whether offered by a British bookmaker or an overseas bookmaker, be subject to the Levy. In order to so offer and promote such bets, overseas bookmakers should be on the "white list", which requires it to comply with British legislation. The Levy is part of the fabric of that legislation and so it is fair and reasonable to require such overseas bookmakers to make Levy contributions in relation to those bets.
- (e) Threshold for abated levy payments: Currently, racing is being denied annual income in the region of £4 million by virtue of the threshold applied for abated levy payments. In our view, threshold levels, below which bookmakers pay Levy at abated rates, have no proper place any Levy Scheme calculated by reference to gross profits<sup>63</sup>.
- (i) The current position
- The Bookmakers have proposed<sup>64</sup> a 10% increase in the threshold figure at which the headline rate of (currently) 10% of gross profits is payable.
  - In September 2006 the Bookmakers' Committee estimated that a 3.25% increase in the threshold for the 46<sup>th</sup> Scheme would reduce Levy income by some £400,000 in a like for like trading year. It is therefore clear that the proposed 10% increase would have an even more substantial impact, at a time when racing has demonstrated that its needs are greater than ever before.

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<sup>63</sup> Although we agree that, if it is determined that such thresholds should remain, they should be increased in line with inflation.

<sup>64</sup> Per the Recommendations by the Bookmakers Committee dated 2 October 2007.

- Racing proposes that there is no longer any justification for smaller bookmakers to pay discounted or abated levy charges, and that all should be subject to the same percentage of gross profits assessment.

(ii) The reasons why the current position is no longer appropriate

- The move from a Levy assessment based on turnover to one based on gross profits removes the possibility of Levy fees being anything other than proportionate and equitable. Because the Levy is now paid on a gross profits basis as opposed to a percentage of turnover, it intrinsically reflects more accurately the bookmakers' ability to pay.
- It should no longer be necessary for smaller bookmakers to be "protected" from the threat of Levy fees disproportionate to their total profits

When British racing was by far the majority business segment of an LBO, and the ability of bookmakers to open new LBO's was severely limited through local licensing restrictions, there was a clear case for the maximisation of Levy through encouraging the prosperity of smaller shops, even if this meant levy collected on a marginal basis in certain circumstances.

We understand that, when racing was by far the dominant product within LBOs, if a bookmaker did not have the systems in place to accurately identify horseracing turnover, the Levy Board typically allowed for an assessment of 75-80% of total turnover as horseracing. In relation to small bookmakers, in a turnover-based Levy environment, a system of abated levy charges for the bookmaker was necessary to encourage the overall financial viability of the betting shop. Without the differential rates in place the smaller bookmaker may well have found it impossible to operate due solely to Levy payment obligations.

This principle was carried forward into the Gross Profits Levy era and the 41<sup>st</sup> Scheme (year 2002/03), but was only accepted by racing because, even at this stage horseracing remained the dominant product and market penetration of new products, FOBTs and virtual racing, was still limited.

- The figures below are for a bookmaker largely unaffected by the small shops threshold and shows the decline in share of Gross Win for horseracing/greyhounds over a 6 year period (further analysis was not given)

	<u>2000</u>	<u>2006</u>
Horseracing + Greyhounds	80%	50%
Machines/FOBTs	9%	30%

- British horseracing now accounts for well under half of the Gross Profit earned in any LBO.

This hypothesis is supported in evidence if one considers one particular element of the changes to be introduced under the Gambling Bill, that of the removal of the demand test. This change was supported by the BBOA (an association for independent bookmakers, now incorporated into the ABB) in early consultation phases of the Gambling Bill. With no demand test in place, there is simply no justification for British racing to bear the brunt of supporting the business model of the smaller bookmaker when they themselves note that they are happy to submit to the rigours of open competition with larger bookmakers through the removal of the demand test.

- The benefit to racing of removing the current approach far outweighs any benefit to bookmakers in retaining it

The position has now been reached whereby the abatements are no longer necessary to protect small bookmakers - the Levy payments due would no longer be disproportionately large when compared with the overall profits of the bookmaker. The proportionality argument has now swung in favour of racing - to remove the abatement and threshold provisions would do no material harm to bookmakers but would provide racing with a significant and important benefit – an increase to the Levy of some £3.75 million per annum.

Racing confirmed that the 46th Scheme was to be the last Scheme to which the different rates would apply.

The minutes of the Levy Board meeting at which the 46<sup>th</sup> Scheme was approved state clearly that racing was accepting the Levy proposal on a strict one off basis as the importance of a swift conclusion to the Levy process at a time of particular political sensitivity was deemed appropriate by all parties.

### **3.3 Conclusion based upon an updated version of the 2002/2003 approach**

**Summary:** If the Levy is to become fit to achieve its purpose, its size and shape must shift in favour of racing. Even if the Determination of the 41st Levy Scheme (2002/3) reached a reasonable conclusion at the time, the same conclusion will, in the prevailing economic climate, no longer be reasonable. Indeed:

- even had circumstances remained the same as those existing at the time of the 41st Levy Determination, the effluxion of time means that the value of its outcome has reduced in real terms, and therefore would in any event require an index-linked increase. Since the 41st Levy Scheme was intended to yield £90million to £105 million, this would necessitate an increase to a range of approximately £111 million to £130 million;

- **however, circumstances have changed which require an additional uplift in the Levy.**
- (a) The Levy amount forecast under the 41st Levy Scheme, the last occasion on which Government determined the Scheme, is below the minimum amount which should be considered for the 47th Levy Scheme, reflecting the rapid growth since 2002 of betting industry profitability and the demands on racing's finances, a significant driver of which has been betting industry requirements. Since the 41<sup>st</sup> Scheme, successive years' Levy Schemes have to a large degree replicated its approach, with relatively minor changes from year to year, albeit changes that, in each year, provided a net benefit to the betting industry (assuming like for like trading) through the continued increase in the level of gross profits that attract a levy charge at less than 10%.
  - (b) That Determination led Government to change the charging basis of the levy from turnover to gross profits – against the recommendations of both racing and the Government-appointed members of the Levy Board – following the change in betting duty from turnover to gross profits.
  - (c) Upon the introduction of Gross Profits Tax, Government had stated that it expected the benefits of the reform to be fairly shared with racing (*“to be sure that any benefits of the reform are fairly shared with racing”* – Stephen Timms 23<sup>rd</sup> January 2001).
  - (d) When Secretary of State Tessa Jowell determined the 41<sup>st</sup> Levy Scheme in January 2002, she said: *“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”*.
  - (e) It is therefore clear that one of the primary intentions in switching to gross profits based schemes (both in terms of tax and also the Levy) was that they would benefit not only the bookmaking industry, but also racing. However, the current relative economic situations in which racing and the betting industry find themselves shows that the Schemes based on the 41st Scheme have operated in such a way so as to have conferred significantly more benefit on the betting industry than on racing. It is not fair or reasonable that this should be allowed to continue.
  - (f) When determining the 41st Levy Scheme in 2002, the Secretary of State confirmed that it *“could yield a figure in the region of £90m to £105m”*. In other words, having conducted an investigation based around needs and capacity to pay, the Secretary of State must have considered it reasonable that the 2002/03 Levy amount would be in that range. As it transpired, the operation of the 41<sup>st</sup> Scheme raised only £79.9m (including the Tote's contribution).

- (g) Taking the intention of the Secretary of State in 2002 (i.e. a target £90 million to £105 million yield for that period), and on the basis of an assumption that:
- (i) racing's needs remain as assessed by Government for 2002/3 (which, as set out in Section 3.1 above, is disputed by racing);
  - (ii) the bookmakers' capacity to pay has remained static and as assessed by Government for 2002/03 (which again, as set out in Section 2.3 and Section 3.2 below, is disputed by racing<sup>65</sup>); and
  - (iii) the costs associated with achieving those needs of racing have increased in line with inflation,

(i.e. use the £90 million to £105 million range that was intended in 2002, and add inflation), this gives a Levy yield requirement for 2008/09 of approximately £111 million to £130 million. See the table below for a comparison of the expected Levy ranges when compared to those actually achieved via the operation of the current approach:

Year	Actual Levy £m	Actual Tote £m	Actual Total £m	Inflation (year to March)	Predicted Levy range (inc Tote) based upon Secretary of State's 2002/03 Determination £m
2002/03	74.5	5.4	79.9		90-105
2003/04	102.0	8.7	110.7	2.61%	92-108
2004/05	97.3	8.3	105.6	3.20%	95-111
2005/06	91.1	8.2	99.3	2.36%	98-114
2006/07	90.0	8.7	98.7	4.82%	102-119
2007/08 F	85.5	8.3	93.8	4.24%*	107-124
2008/09 F	85.5	8.3	93.8	4.24%*	111-130

F - Forecast Numbers from HBLB  
\* inflation for year to October 2007

- (h) If we use the HBLB's own forecasts<sup>66</sup> to estimate British racing gross win for 2008/09, then this would require a headline percentage levy rate of 11.8% to

<sup>65</sup> And also on the basis that consideration is not given to other economic, social and fiscal circumstances.

<sup>66</sup> The HBLB's forecast for the 47th Levy is £93.8 million (including the Tote). The current yield is (taking account of small bookmakers abated rates) approximately 9.7%, which would lead to a calculation of British racing's gross win being £967 million. This would mean that the lower and upper range of gross win charges should be 111.12 / 967 and 129.63/967 respectively, i.e. (if no small bookmaker abatements rates were applied) 11.5% and 13.4% or (if they were) 11.8% and 13.7%. NB - this does not take into account any "double indexation".

13.7% of gross profits in order to deliver the required £111 million - £130 million<sup>67</sup>.

- (i) It follows that, assuming that the 41st Scheme was "reasonable", and based upon the outcomes for the 41st Scheme as they were intended to operate by the then Secretary of State, the starting point for consideration of the 47th Scheme, had conditions remained unchanged in the interim, should correctly be £111 million -£130 million, simply to reflect index-linked inflation.
- (j) However, as highlighted in Sections 3.1 and 3.2 above, the economic landscape has changed since the last Determination in 2002. It follows that if the Levy is to become fit for purpose, it must now in fact push above these index-linked parameters and further shift in favour of racing so as to redress the current imbalance by addressing:
- Needs: Section 3.1 set out racing's "needs", which have significantly increased since 2002.
  - Capacity to pay: Sections 3.2 focuses on the bookmaking industry's "capacity to pay" the Levy and confirms that, contrary to the assertions of that industry, this is greater than ever before.
  - Prevailing conditions: Section 2.3 confirms that the Secretary of State must consider prevailing economic, social and fiscal conditions when considering "needs", "capacity to pay" and otherwise, and these are also considered in this Section 3.

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<sup>67</sup> This assumes that the scheme of abated rates for small bookmakers would remain in place. These percentage levels would inevitably decrease if the extent of leviable revenues was extended in line with racing's proposals as set out in Section 3.2.4.

## **SECTION 4 METHODOLOGY 2**

Racing has validated the analysis set out at Methodology 1 by commissioning independent economic analysis, undertaken by LECG, to consider the value range that British horseracing could reasonably expect to secure from betting operators, should there be a commercial mechanism which operated on an equivalent basis to the Levy.

The first part of LECG's analysis indicates that a range would be likely to be significantly higher than the current levy. The analysis indicates a return in a range of 15% - 19%, or £152 million - £186 million in total (using 2006 figures).

A second analysis estimates the scale of additional contribution based on a full recognition of value across all relevant revenue lines. This might add an additional 2.6% - 4% to the levy, or £14 million - £22 million (using 2006 figures). This implies a total range for the levy of 18% - 23%, or £177 million - £225 million.

### **4.1 Introduction:**

Racing has sought to test and validate the analysis set out at Section 3 by commissioning independent economic analysis, undertaken by LECG, to consider the value that British horseracing could reasonably expect to secure from betting operators, should there be a commercial mechanism available to charge for 'access' to the sport. LECG's report presents an analysis of how the level of horseracing levy might be determined in a market setting applying commercial principles. It develops an economic framework and uses this to derive a range of possible levy prices. A copy of the full report is attached at Appendix 1.

### **4.2 Summary**

We would summarise LECG's report as follows:

- (a) **Methodology:** LECG's analysis is based on the price that might be agreed for access to racing if this were determined in a hypothetical market. It compares the maximum value that the bookmaking industry ("betting") might be prepared to pay for access, and the minimum that British horseracing ("racing") might be prepared to accept, and a price is agreed within these bounds. Similar techniques are widely used in economics in determining royalty rates for technology and in other contexts. The analysis does not depend on institutional details of the levy but considers a general price for access, mimicking the key aspects of the levy in a market context. The main analysis focuses on the impact of British racing on licensed betting offices (LBOs) (UK retail) as the main component of levy income.

- (b) **Analysis**
- (i) The first part of LECG's analysis indicates that a reasonable range of return is likely to be significantly higher than the current levy. Based on an assessment of the direct contribution of British horse racing to betting earnings and the costs to racing of providing the required level of fixtures, the analysis indicates a levy in a range of 15% - 19%, or £152 million - £186 million in total (using 2006 figures). Other estimates are made using different values for the key parameters.
- (ii) Taking account of the additional value that betting gains from sales of other products such as FOBTs and other LBO betting made possible by racing, our view is that an agreed levy is likely to be significantly higher than the figures referred to at (a) above. The second part of LECG's analysis estimates the scale of the additional contribution of racing to sales of other betting products – which is not reflected in the current levy but would be reflected in a price agreed in a commercial setting. This indicates that racing's full contribution to betting revenues and profits might be up to a third or more higher than that based only on direct racing betting. In terms of the negotiated price this might add an additional 2.6% - 4% to the levy, or £14 million - £22 million (using 2006 figures). Added to the direct effect this implies a total range for the levy of 18% - 23%, or £177 million - £225 million.
- (c) **Survey of betting habits**: A review of a survey of punters' betting habits in LBOs confirms that racing is likely to have a positive impact on other betting earnings in addition to earnings from racing betting itself. A brief review of advertising patterns indicates that bookmakers actively promote other betting to racing punters, implying that racing betting may be diverted into other products.
- (d) **A commercially determined levy is likely to be higher than current levels**: These results add weight to arguments that the current levy significantly under-rewards racing for access, both by paying less than would be agreed in a commercial setting based on its direct contribution to betting and by making no allowance for the contribution racing makes to the sales of other betting products.
- (e) **Betting exchanges**: An initial analysis of betting exchanges suggests that there is scope for further review of the appropriate levy for exchanges, which the current report has been unable to pursue in depth. Prices agreed in a commercial framework for access are likely to be higher than currently and possibly higher than those that would be agreed for LBOs. Commercially determined prices could, in theory, correct for any competitive advantage of exchanges may have compared to other betting due to a possibly lower effective cost of access to racing paid by exchanges in the current levy system.

## **SECTION 5 RACING'S CONCLUSION AND RECOMMENDATIONS FOR THE 47<sup>TH</sup> SCHEME**

Determining the fair and reasonable return to Racing through the Levy is a complex process. We have sought to adopt a reasonable approach.

We have taken as our starting point the last Levy Scheme that was subject to Determination, and updated the Secretary of State's conclusions to reflect conditions in 2008.

The last time the Levy was determined, requiring the Government to assess the "needs of racing" and "the capacity to pay of betting operators", was in 2002. An independent analysis undertaken by OCP consultants led to Tessa Jowell determining that the 41st Scheme should achieve a return to racing within the target range of £90 to £105 million.

We have taken this outcome, and updated it to 2008, taking into account the following factors, which are set out in detail in our submission as to the needs of racing:

- Indexation between 2002 and 2008.
- The increase in fixtures from 1,158 in 2002 to a programmed 1,504 in 2008, an increase of 30% at a cost of £22 million.
- The £10 million increase in integrity and regulatory costs accruing to British horseracing. These were £15 million in 2002, and will be £25 million in 2008.
- A specific increase in resource for the promotion of the sport. We state this as an additional £4 million, which is the equivalent of the expenditure by the Levy Board in 2002.

This is against the backdrop of significantly increased capacity to pay of the betting sector since 2002 (evidenced by the gross win of the two leading bookmakers rising from £1.1 billion in 2002 to £1.8 billion in 2006).

Taking account of indexation within the increased costs in relation to fixtures, and integrity and regulatory costs, and allowing for fixture related increases in the latter, our analysis shows that **a fair and reasonable return to British horseracing requires a Levy return in the range of £135 to £153 million in 2008/09**. This equates to a gross win rate on British horseracing for all betting operators of between 14% and 16%.

The separate analyses undertaken for us by LECG conclude that the value of British Horseracing product to Licensed Betting Offices, on a conservative basis, is within a range of £152 to £186 million. Expressed as a gross win percentage this would be in the range of 15% to 19%. This range increases to a range of 18% to 23%, or £177 to £225 million when the link between racing product and its contribution to the betting operator business, that we say exists, is fully and properly recognised.

**We have given these findings very careful consideration, and our proposal to you is that the next Levy Scheme should specify a payment of 15% of gross profits on British horseracing by off-course bookmakers.**

This is an increased rate in comparison to the 46<sup>th</sup> Scheme. However, 15% is the mid point in the range we identify from our analysis based on bringing the 41st Scheme up to date. It is also the bottom end of the lower range of reasonable outcomes from the LECG analysis, despite our case that the higher range applies.

We have chosen to take this reasonable route to reflect our continuing desire to adopt a business-like relationship with betting operators within the existing Levy framework, and to support Government in its stated desire of completing the Determination as soon as possible in the New Year.

We believe that this Determination result would allow Government to achieve the objective it has set, as stated by both Stephen Timms in 2001 when betting tax was reformed, and Tessa Jowell in 2002, that racing and betting should share in the benefits of the new legal and fiscal framework introduced for betting operators.

**All our figures assume the end of abated rates of levy for small bookmakers.** If the current scheme of abated levy payments continues, then the headline percentage numbers quoted here would need to increase by 0.3% to maintain the financial return to racing at the fair and reasonable level we propose.

Income to the Scheme from other sources is small, and the detail of any Scheme must balance the potential sums to be raised using the methods outlined above against the costs of collection and administration on both the Levy Board and the betting operator in these sectors. **For this reason, we propose that for spread betting firms, on-course bookmakers and bookmakers betting solely on Point-to-Point, harness racing and trotting, the 47<sup>th</sup> Scheme replicates the 46<sup>th</sup>.**

There is one further important element to the Determination which we believe must be addressed separately. **Betting exchanges now require specific consideration.** In 2002, they were a relatively new market entrant. Now they are a significant and established part of the betting market place.

As they operate a different business model to betting operators, it is right that their Levy contribution made by this sector of the betting market is given full consideration, separate from that of other traditional operators. Our analysis concludes that there needs to be a significant increase in the Levy payments from this sector to ensure that it is making a return to racing that is seen as fair and reasonable when compared to that made by other parts of the betting industry.

The exchange market's contribution to the 45<sup>th</sup> Scheme (2006/7) was £6 million. As part of delivering the increased levy return set out above, this needs to increase to £20 million. The different business model of betting exchanges requires a different levy charging mechanism within the existing framework. **Using the same net winnings basis as exchanges themselves use to charge their customers,**

**racing proposes a charge on exchanges equivalent to 1.15% of their customers' net winnings.**

**If this fair and reasonable return from exchanges is established, it would allow the headline gross win levy rate for traditional bookmakers to be reduced to 14%.**

**APPENDIX 1 - LECG REPORT**

(for versions of the document sent as e-mail this Report is a separate attachment)



## **APPENDIX 2 - SUMMARY OF THE LEGISLATIVE PROVISIONS ESTABLISHING THE BASIS OF THE LEVY**

### **Legislative basis for the Need/Capacity to Pay Test**

#### 1 *Summary*

The Need/Capacity to Pay Test (set out in full below), in relation to the Levy payable by off-course bookmakers, was first introduced in 1961. Although removed from the statute book in 1969, the test has been applied whenever the Secretary of State has been called upon to make a Determination of the Levy amount.

In spite of this consistent application, it was clearly the Government's intention, when removing the Need/Capacity to Pay Test from the statute book in 1969, that the Home Secretary should be able to make a reasonable decision based on all relevant factors, not simply those included within the Need/Capacity to Pay Test (see below). "All concerned would probably agree that the intention at which we are aiming is to determine not what bookmakers are capable of paying, but what it is reasonable for them to pay. Their view of this will often, if not always, differ from that of horseracing interests." (Horseracing Betting Levy Bill 1969 - 5 March 1969, 565).

#### 2 *The Betting Levy Act 1961 ("1961 Act") - The introduction of the Levy, and the Need/Capacity to Pay Test*

The 1961 Act introduced the concept of a levy being payable by off-course bookmakers (a tote-based system already existed). In spite of arguments to the contrary during parliamentary debate in advance of enactment, the 1961 Act took a non-prescriptive stance as to the nature and operation of the levy. Despite the creation of certain parameters, the Act essentially left the industry to devise its own collection and distribution schemes. "*The various boards and tribunals would be, as far as possible, autonomous. Government intervention would be kept to a minimum. The government is really just providing the horse racing industry with the necessary machinery to operate the scheme*" (per Home Secretary (the promoter of the Bill) during Hansard re: the 1961 Act - 5 December 1960, 878).

Section 1 of the 1961 Act established the Horserace Betting Levy Board for the purposes of assessing and collecting monetary contributions from bookmakers and from the Tote, such monies to be applied in accordance with the schemes approved by the Secretary of State for the purposes, set out in Section 1(1) (which were mapped across from the Racecourse Betting Act 1928 which applied a "levy" to on-course bookmakers), which are as follows:

*"(a) the improvement of breeds of horses;*

*(b) the advancement or encouragement of veterinary science or veterinary education;*

*(c) the improvement of horse racing".*

Section 3 of the 1961 Act sets out the parameters of the schemes (for assessing the amount, and contributions to be made by various categories of bookmaker) which are to be devised by the bookmakers' committee, for approval by the Levy Board. If approval was not given by the Levy Board, the three independent members (including the chair person) of the Levy Board were, under Section 3(6), to consider and compare:

- the extent of the need for the time being for contributions for the purposes of (a) to (c) above;
- the capacity for the time being of bookmakers to make contributions for such purposes; and
- the capacity for the time being of the Totalisator Board to make such contributions

(the "**Need/Capacity to Pay Test**"), and in the light of such consideration/comparison, the independent members were to make their own determination of the scheme to apply.

The 1961 Act made it clear that the Levy is payable only by bookmakers who carry on a business which includes the "*effecting of betting transactions on horse races*", and is "*only in respect of so much of the business of the bookmaker as relates to such betting transactions*" (section 3(2)(a)).

### 3 *The removal of the Need/Capacity to Pay Test - The Betting, Gaming and Lotteries Act 1963 ("1963 Act") and the Horserace Betting Levy Act 1969 ("1969 Act") and the Horserace Betting and Olympic Lottery Act 2004 ("2004 Act")*

The 1963 Act consolidated various provisions in relation to betting, gaming and lotteries, such that Section 1 of the 1961 Act became Section 24 of the 1963 Act (which remains on the statute book) and Section 3 of the 1961 Act became Section 27 of the 1963 Act. The provisions of the 1963 Act remain substantially on the statute book, with the notable exception that Section 27(5) of the 1963 Act (which replaced Section 3(6) of the 1961 Act - i.e. the Need/Capacity to Pay Test) was repealed by Section 7(4) of the 1969 Act.

The effect of this repealing is that the Need/Capacity to Pay Test no longer has statutory force and the determination of schemes which cannot be agreed by the Bookmakers' Committee and Levy Board no longer falls to be decided by the independent members of the Levy Board. Instead, under the 1969 Act, schemes are to be referred to the Secretary of State for Determination. Under the terms of the 1969 Act, the Secretary of State is not

expressly required to consider the Need/Capacity to Pay Test - the removal of the test was very controversial at the time. This removal was justified, inter alia, on the basis that the phrases were difficult, if not impossible, to interpret usefully and on the basis that the Secretary of State "*should be given a much wider discretion*" to take into account not just need and capacity to pay but "*all manner of other considerations*".

The 2004 Act included provisions giving the Secretary of State the ability to abolish the Levy and the Levy Board, with the intention that they would be replaced by a commercial arrangement for funding the industry. As a result, the Gambling Act 2005, together with other legislation, was drafted on the assumption that the Levy and the Levy Board (together with the Tote in its current form) would be abolished. However, the European Court of Justice's November 2004 ruling against BHA on database rights in fixture lists etc cast serious doubt over racing's ability to secure adequate payment for the use of its data, and therefore over the viability of the proposed replacement funding model. As a result of that ruling and the recommendations of the Future Funding of Racing Review Group, Richard Caborn, the then Sports Minister, announced in December 2006 that the levy and the Levy Board should be retained until such time as a secure alternative commercial funding arrangement could be identified. Therefore, the provisions relating to the Levy in the 1963 Act as amended by the 1969 Act remain in force by virtue of Gambling Act 2005 (Commencement No 6 and Transitional Provisions) Order 2006 (the 1963 Act is otherwise repealed by the Gambling Act 2005). The survival of these provisions until the eventual abolition of the Levy has been confirmed in The Gambling Act 2005 (Horserace Betting Levy) Order 2007.