



MEMORANDUM TO THE SECRETARY OF STATE FOR  
CULTURE, OLYMPICS, MEDIA AND SPORT

SUBMITTED  
BY  
THE BOOKMAKERS' COMMITTEE

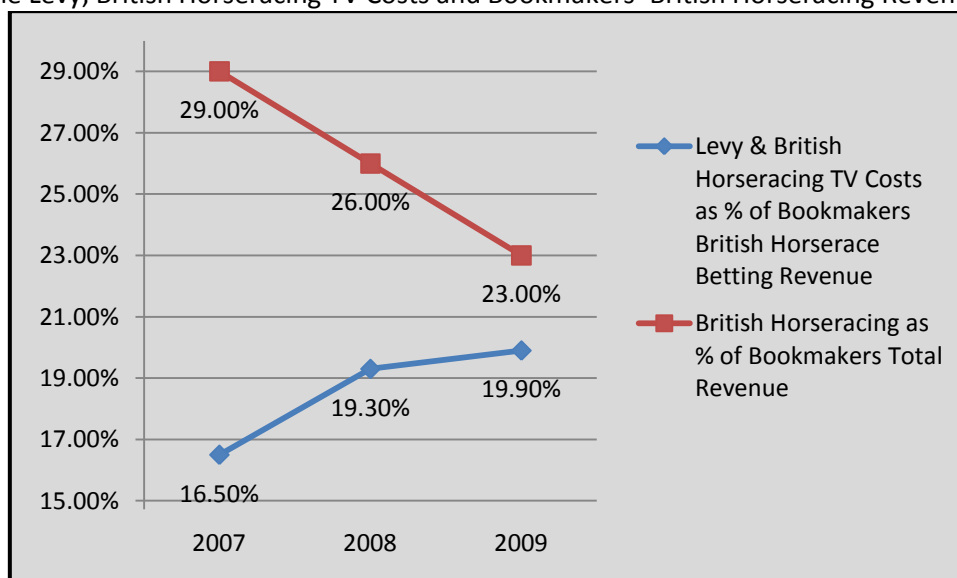
CONCERNING THE DETERMINATION  
OF THE  
50<sup>TH</sup> ANNUAL HORSERACE BETTING LEVY SCHEME

## **EXECUTIVE SUMMARY**

1. The Bookmakers' Committee (the Committee) urges the Secretary of State to:
  - Consider the initial submission made by the Committee and the arguments submitted therein in respect of TV picture rights, the reducing relevance to bookmakers of British horseracing and the economic downturn.
  - Note that neither Racing nor the Government Appointed Members (GAM) submission has established a need that is not currently being met.
  - Reject the recommendation submitted by the GAM as it is:
    - (a) wrong in its methodology and reasoning.
    - (b) wrong in its assumptions and forecasting.
    - (c) made without any assessment of its impact on bookmakers and unreasonably targets those bookmakers with the least capacity to pay.
  - Give appropriate consideration to the Deloitte LLP 'Report for the Government Appointed Members of the Horserace Betting Levy Board'.
  - Announce that the Horserace Betting Levy will cease on 31 Mar 14.

2. The level of funding transferring from Bookmaking to Racing through the Levy, TV picture rights and sponsorship has remained stable over recent years. The average annual total revenue received by Racing from Bookmaking in the period 2006-2010 was £164m.<sup>1</sup> In 2010 this figure was £160m<sup>2</sup>, only £4m (2.5%) below the average for the period. This is unsustainable given the decline in bookmaker's revenue generated by British horseracing over the same period. Racing cannot reasonably expect to continue to benefit from the increase in funds received from TV picture rights since 2008/9 and also retain the same or increased level of Levy. **Figures 1 and 2** show the decline in revenue and EBITDA terms.

**Figure 1** The Levy, British Horseracing TV Costs and Bookmakers' British Horseracing Revenue.<sup>3</sup>

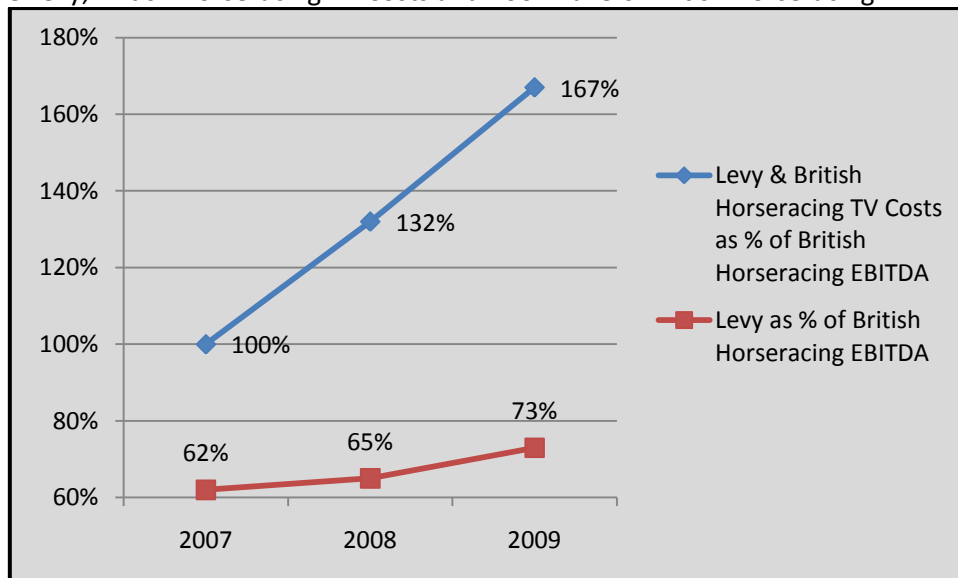


<sup>1</sup> GAM Independent Assessment, Annex A, dated 29 Sep 10.

<sup>2</sup> Ibid.

<sup>3</sup> Ernst & Young, '50<sup>th</sup> Horserace Betting Levy Scheme, Report for the Bookmakers' Committee-Analysis Update'.

**Figure 2** The Levy, British Horseracing TV Costs and Bookmakers' British Horseracing EBITDA.<sup>4</sup>



3. Between the 49<sup>th</sup> Levy Scheme (freely agreed by the Horserace Betting Levy Board, the Committee and Racing), which was seen to be a fair balance between Racing's 'need' and the bookmakers' capacity to pay, and the 50<sup>th</sup> Levy Scheme, Racing's 'need' has not changed but the bookmakers' capacity to pay has substantially reduced.

4. At no stage has Racing provided tangible evidence of a 'need' over and above what it currently receives. It is strange therefore that the GAM submission sets a 'target yield' (which is by default their perception of 'need') without the benefit of robust data or a business case from Racing. The Committee rejects the methodology and reasoning upon which the GAM based their arguments and, as a consequence, the conclusions and recommendation which flowed from them.

5. The GAM submission appears to have replaced the statutory balance to be struck with something that suits the Board's requirement to repair its balance sheet. Bookmakers are being asked to pay for historic failures of the Horserace Betting Levy Board (the Board) which, during the period 2006-2010, spent £57.35m more than was received in levy. The Board has already budgeted to expend £60m in 2011, which has had a substantial impact on project prize money allocation, but this ignores Racing's other income streams. The Committee therefore rejects the purported 'need' of Racing for £75-£80m.

6. The Committee rejects the GAM use of 'target yield' as the starting point from which a Levy Scheme is subsequently generated. This is reverse-engineering a Scheme to achieve a particular objective and to justify the figures which have been proposed and has the effect of making their flawed analysis of the needs of Racing **the** determining factor in their recommendation. Moreover, it is not the role of the Board to fix the amount of levy paid each year by bookmakers. Its role is, if possible, to reach agreement with the Committee on the rates, terms, conditions and definitions to be applied during the following year's Levy Scheme. By definition, the Levy is a mechanism and as such does not and cannot support an argument to establish a 'target yield'.

7. The GAM submission is wrong not to consider increased TV picture rights costs<sup>5</sup> extant (unresolved during the determination of the 47<sup>th</sup> Levy Scheme) **and** in the future. The Committee believes they are excluded only to protect the concept of a 'target yield'.

<sup>4</sup> Ibid.

<sup>5</sup> Since 2008.

8. The Committee believes that the assumptions on which the forecasts for the 50<sup>th</sup> Levy Scheme contained within the GAM submission are based, are wrong. The GAM submission forecast yield for the 50<sup>th</sup> Levy Scheme is based on a flawed assumption as its start point. If the GAM recommendation were to be implemented, this would result in a yield well above that stated by the GAM. The Committee believes that the correct start point would lead to forecast yields significantly greater than stated by the GAM. **(Table 1)**

**Table 1** Comparison between Bookmakers' Committee and HBLB Assessments of Potential Yields.<sup>6</sup>

Yld	Bookmakers' Committee Assessment			HBLB Assessment		
	Bookmakers' Committee Recommendation	'Rollover'	GAM Recommendation	Bookmakers' Committee Recommendation	'Rollover'	GAM Recommendation
Low	£58m	£66m	£83m	£50m	£58m	£76m
High	£61m	£69m	£85m	£57m	£65m	£82m

9. The abolition of thresholds and re-introduction of foreign racing is backward looking, unequal in its approach to the treatment of Bookmaking and Racing, and irrational. The perceived (by Racing and the Board) lack of funding from exchanges and off shore has led to an increased burden on leviable bookmakers, and in particular, the Licensed Betting Offices (LBO) and further, those LBO at the lower end of the profitability scale which can least afford to pay more. In short, the GAM recommendation targets those LBO which have the lowest capacity to pay. A total of c. 416 LBO would close with the total loss of c. 2000 jobs.

10. Under the GAM recommended Levy Scheme:

- Between 2893 (36%) and 3326 (41%) LBO will pay at least 50% more Levy than they did under the most up to date completed Scheme (48<sup>th</sup> Levy Scheme).<sup>7</sup>
- Between 1552 (19%) and 1818 (22%) LBO will pay at least 100% more Levy than they did under the most up to date completed Scheme (48<sup>th</sup> Levy Scheme).<sup>8</sup>

11. The Committee is concerned that the GAM submission fails to address or simply discounts much of the wholly independent advice specifically sought by them and provided to them by Deloitte LLP. The Committee urges the Secretary of State to give appropriate consideration to the Deloitte LLP 'Report for the Government Appointed Members of the Horserace Betting Levy Board', dated 19 Oct 10, during his determination.

12. The GAM submission recommends a radical change to the Levy mechanism which reflects their lack of knowledge of the bookmaking industry and disregards the advice given to them by bookmakers' representatives, industry subject matter experts and professional advisors.

13. It is clear that the Levy is no longer fit for purpose and the Committee urges the Secretary of State to announce an end date for the Levy of 31 Mar 14. Such a decision should provide the required impetus for Bookmaking and Racing to reach agreement on a suitable commercial replacement.

14. Should the Secretary of State decide it is appropriate to await the outcome of the Levy-related Bookmaking and horseracing matters outlined in this submission, the Committee would suggest

<sup>6</sup> Source: Bookmakers' Committee and Board Executive.

<sup>7</sup> Source: Board Executive.

<sup>8</sup> Source: Board Executive.

consideration be given to a determination which requires a rollover of the 49<sup>th</sup> Levy Scheme with appropriate adjustments for RPI where applicable.

15. This submission is influenced by extensive legal advice received by the Committee. The legal advice, protected by legal professional privilege, is made available to the Secretary of State under separate cover on a confidential basis.

## **INTRODUCTION**

16. The Board and the Committee have failed to agree the terms and conditions of the 50<sup>th</sup> Levy Scheme and, in accordance with current legislation, the matter has been referred for determination by the Secretary of State.

17. The Committee very much regrets that determination has become necessary, as, in formulating its recommendations for the 50<sup>th</sup> Levy Scheme, the Committee took full account of the environment in which the Board, Bookmaking and Racing find themselves.

18. Three major issues affected the context within which the Committee's recommendations were submitted. These will be discussed individually and in detail later in this memorandum but it is necessary to make clear that, throughout the discussions leading up to 31 Oct 10, the Committee was fulfilling its statutory obligation to make recommendations for the 50<sup>th</sup> Levy Scheme which were lawful and capable of being accepted within the general principles of public law.

19. Thus it had in mind, as on every previous occasion, the fact that the Levy is not a commercial vehicle for funding Racing but a statutory mechanism introduced for the purpose of compensating for potential reductions in gate receipts when off-course betting was legalised. The Secretary of State will have been made aware that, during the passage of the original legislation the then Home Secretary stated that the point of the Levy was not to benefit any sectional interest, but to enable a great national sport and a great national industry to help itself.

20. The most recent determination, which took place three years ago and concerned the 47<sup>th</sup> Levy Scheme (2008/09), occurred because of fundamental changes in the economic context within which the negotiations leading up to that referral took place. Primarily, these centred upon the significantly increased TV picture rights payments made by bookmakers, and received by Racing, following the launch of TurfTV and the increased costs resulting from the introduction of the Gambling Act 2005. The issue of TV picture rights payments were acknowledged, but not resolved, by the Secretary of State within the determination of the 47<sup>th</sup> Levy Scheme.

21. It is our view that, once again, it is the Board's failure to acknowledge and respond to fundamental changes in the economic environment now affecting bookmakers (partly due to the unresolved TV picture rights issue highlighted during the determination of the 47<sup>th</sup> Levy Scheme) that has led to the impasse which precluded an agreement on the 50<sup>th</sup> Levy Scheme.

22. Accordingly, the Committee urges the Secretary of State to determine a Scheme appropriate to current circumstances. The Committee does not consider that the recommendation put forward by the GAM meets this test for reasons which we address in this memorandum, not least of which is that it is highly regressive in nature because, in effect, it targets those LBO which have the lowest capacity to pay.

23. If the Secretary of State were to accept the GAM recommendation, a significant extra non-government tax burden (estimated at £20 million) would be imposed across the bookmaking industry at a time when the industry has been negatively affected by the rise in non-recoverable VAT on expenditure and is still striving to mitigate the effects of the economic downturn. In addition, the VAT increase effective 4 Jan 11 is likely to restrict further the spending power of betting customers and will increase bookmaker VAT costs by, we estimate, at least £60m. This is a cost we bear as part of the national strategy for economic recovery but, being largely irrecoverable for bookmakers, comes straight off the bottom-line. This will reduce profits and consequently the industry's capacity to pay yet more Levy.

24. The Committee considers the Levy to be an anachronism in that it no longer truly satisfies the purpose of its creation. Put in place as a statutory, non-commercial method of transferring funds from Bookmaking to Racing, there is an increasing tendency to try and convert it into a value-based, commercial

vehicle, which is a role it cannot fulfil, not least because no market mechanism to establish any proper 'value' exists. The circumstances and context in which the Levy was created are no longer relevant, and the advancement of technology and changing demographic interests render it unable to undertake the role for which it was intended. It is no longer fit for purpose and the Committee urges the Secretary of State to announce an end date for the Levy of 31 Mar 14. Such a decision would provide the required impetus for Bookmaking and Racing to reach agreement on a suitable commercial replacement.

25. This submission is influenced by extensive legal advice received by the Committee. The legal advice, protected by legal professional privilege, is made available to the Secretary of State under separate cover on a confidential basis.

## BACKGROUND

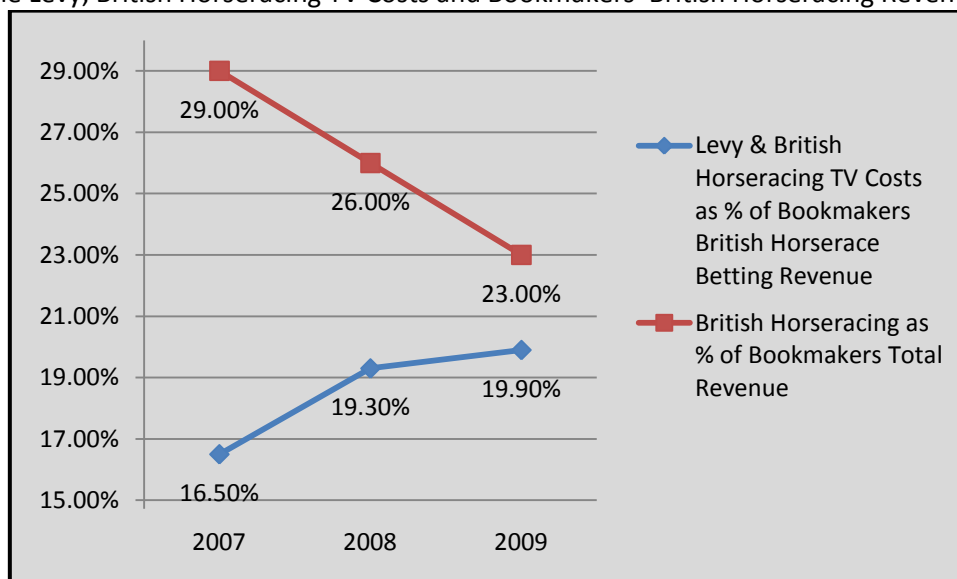
26. This section addresses the three most significant issues considered by the Committee when formulating its recommendations for the 50<sup>th</sup> Levy Scheme and which led ultimately to the conclusions reached in that submission. They are addressed in some detail as they are fully relevant to the determination process.

27. The point of the Levy is that in the absence of commercial sustainability, it should balance Racing's needs against the bookmakers' capacity to pay.

28. The cost of providing live TV pictures in LBO, the continuing decline in the popularity of betting on British horseracing and the impact of the economic downturn are central to the determination of the Levy. They are pivotal to the balancing exercise that requires the Levy mechanism to take into account all prevailing economic, fiscal and social circumstances.

29. Because the capacity of bookmakers to pay the Levy has always been one of the two main considerations in the setting of the annual Levy (the other being the needs of Racing), the Committee this year made Recommendations which reflected the current environment and in particular, its effect on LBO, which contribute 72% of the Levy.<sup>9</sup> LBO are the bookmaking platform most affected by the burden of significantly increased regulatory and TV picture rights costs since 2007/08, the continued reduction in relevance of British horseracing to the betting customer, the wider economic downturn and the consequent reduction in capacity to pay. **(Figure 3)** Other LBO costs include Gambling Commission fees and compliance costs, increases in rent and rates, increased marketing costs and the national minimum wage. Most are rising faster than inflation, leading to diminishing profitability and capacity to pay Levy.

**Figure 3** The Levy, British Horseracing TV Costs and Bookmakers' British Horseracing Revenue.<sup>10</sup>



30. The level of funding transferring from Bookmaking to Racing through the Levy, TV picture rights and sponsorship is unsustainable. Racing cannot reasonably expect to continue to benefit from the increase in funds received from TV picture rights since 2008/9 and also retain the same level of Levy. Racing's income is moving toward a commercial basis through media rights, and this is appropriate. However, Racing cannot expect to continue to receive an increasing 50 year old subsidy and at the same time exploit its commercial advantages.

<sup>9</sup> Source: HBLB Annual Report 2009/10.

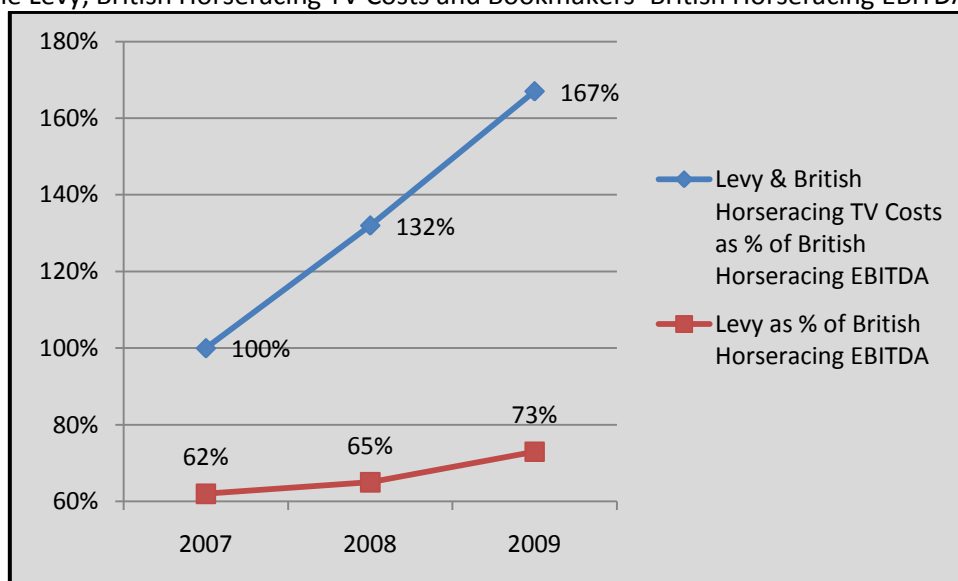
<sup>10</sup> Ernst & Young '50<sup>th</sup> Horserace Betting Levy Scheme, Report for the Bookmakers' Committee-Analysis Update'.



31. The forecast reduction in yield between from the 48<sup>th</sup> to the 49<sup>th</sup> Levy Scheme has provided the catalyst for some degree of internal restructuring within Racing (new commercial arrangements between some of the constituent parts); it follows therefore that the notion that Racing needs a subsidy as its lifeblood is nonsense. With racecourse attendances up and stability in the number of horses in training, there is simply no credible evidence that Racing is in crisis.

32. British horseracing is, however, reaching a "tipping point" with regard to its profitability to bookmakers and therefore its viability for LBO operators. Bookmakers cannot be expected to shoulder the burden of the Levy, even at current rates, without the risk of significant shop closures and job losses simply to disproportionately increase Levy monies to which the racing industry appears to believe it is entitled. **(Figure 4)**

**Figure 4** The Levy, British Horseracing TV Costs and Bookmakers' British Horseracing EBITDA.<sup>11</sup>



### TV Picture Rights

33. The introduction since 2007 of *upstream* competition for the TV picture rights for British horseracing without the ability to compete *downstream* (because both TV services<sup>12</sup> are seen by the majority of bookmakers as 'must haves') has led to the unsustainably high transfer of funds from Bookmaking to Racing, on a 'product' which is fast losing its relevance to betting customers.

34. Whilst there has been *upstream* competition for these rights, there is no *downstream* competition in the supply of the pictures to betting shops as the rights are controlled by individual companies - pictures from 31 of the 59 British racecourses can only be bought from TurfTV and the remainder can only be bought from SIS. Accordingly, subject as they are to a duopoly of supply, betting shop operators cannot use competition of supply to negotiate commercially favourable costs.

35. During the determination of the 47<sup>th</sup> Levy Scheme, the Minister accepted that an argument could be put forward thus:

*'I therefore accept that it may have a material effect both on bookmakers' ability to pay and on the needs of racing'.*

<sup>11</sup> Ibid.

<sup>12</sup> Satellite Information Services (SIS) Ltd and TurfTV.

36. At the time, it was said that, because the extra cost [of subscribing to the TurfTV service] was not known, the impact could not be adequately assessed and the Minister stated that:

*'In time its full economic impact on bookmakers, racecourses and on horseracing generally may become clearer.'*

37. This impact is now evident and is addressed in the Committee's recommendations for the 50<sup>th</sup> Levy Scheme. It is clearly the case that the transfer of funds from Bookmaking to Racing via TV picture rights past, present and future, must be fully taken into account in any approach to determine the Levy.

### **The Reducing Relevance of British Horseracing**

38. The popularity of British horseracing among betting customers continues to decline, continuing the trend of the past 10 years. Racing's authorities are not only aware of the causative issues behind this but have driven the policies behind them despite the negative effect on bookmakers income from British horseracing and thus Racing's income from the Levy (examples include accepting sponsorship from non-Levy generative bookmakers; 48 hour declarations; confliction of live TV pictures between two providers; streaming of pictures via the internet; and the saturation of accessible TV channels by racing coverage). All of these detract from betting customers betting in the LBO which, at 72% of the total, is easily the most significant Levy generative sector.

39. It would be unreasonable to suggest that against a market background where bookmakers' British horseracing turnover and profit continues to decline, the amount of money transferred by statute from Bookmaking to Racing via the Levy should nonetheless increase. **(Figures 3 & 4 above)**

### **The Economic Downturn**

40. The bookmaking industry within the UK is a significant employer. It has to date remained so during the economic downturn and would wish to continue to be so in the future despite the economic outlook. Bookmaking has 'cut its cloth' and significant numbers of unprofitable LBO have closed. The last racecourse to close (with the exception of Great Leighs which did so 9 months after opening, due to a flawed business plan) did so in 1981.

41. As is universally recognised, the economic downturn has resulted in lower levels of personal disposable income and significant competition exists for the 'leisure pound'. Competition between different gambling options and other leisure activities results in the betting customer (many of whom fall into the demographic that has been hardest hit by the downturn) choosing how to spend their money. Racing does not appear willing to accept this matter of fact nor indeed seem particularly keen to compete for the 'leisure pound'.

42. The economic pressure on the UK bookmaking industry is clear. Recently released figures from the Gambling Commission for FY 09/10, show that the overall value of bets placed with bookmakers fell by 11% for off-course bets, 25% for on-course bets and 21% for pool betting. As far as British horseracing itself is concerned, off-course turnover fell by 4% and gross profit fell by 10%. These are economic realities which Racing must accept and which this determination must take fully into account.

### **Bookmakers' Committee Recommendations**

43. A copy of the Committee's Recommendations for the 50<sup>th</sup> Levy Scheme is at **Enclosure 1**.

44. The only significant change from the 49<sup>th</sup> Levy Scheme (which was freely agreed between the Board, the Committee and Racing) was a recommendation to increase to £123,000 the threshold figure at

which the headline rate of Levy becomes payable by LBO. This recommendation was made for the following reasons<sup>13</sup>:

- *'preserve employment in an industry employing over 40,000 people.'*<sup>14</sup>
- *limit the number of lower turnover shops likely to close. Media rights are fixed costs and thus affect medium and low turnover shops most.*
- *help to maintain levy contributions by keeping shops open.*
- *reduce the structural competitive advantage of those bookmakers not paying levy, and help arrest the decline of leviable betting on horseracing.*
- *ameliorate the cost implications of those who directly fund the extra £56.1m now received by racing [from the sale of TV picture rights] over and above the levy.'*<sup>15</sup>
- *maintain the incentive to both racing and LBO to maximize the potential of British horserace betting.*
- *maintain revenue streams to HMG through VAT, GPT and licence fees'.*

### **The Statutory Process**

45. The submission of recommendations by the Committee for each Levy Scheme is a statutory requirement. This year, in attempting to maximize the time available to reach agreement with the Board, the Committee submitted its recommendations in respect of the 50<sup>th</sup> Levy Scheme on 14 Jul, much earlier than has usually been the case.

46. Prior to 14 Jul the Committee convened on 29 Mar, 1 Jun and 5 Jul to discuss their recommendations. These discussions were influenced by the extensive input received from professional advisors contracted to assist the Committee in formulating its recommendations.<sup>16</sup> In addition, a number of Drafting Committee meetings took place and in all, five drafts were circulated prior to final endorsement of the recommendations by the Committee.

47. At its meeting on 15 Sep 10 the Board rejected the Committee's recommendations.

48. On 27 Oct 10, Paul Lee, Chairman of the Board wrote to Will Roseff, Chairman of the Committee and stated that the reason for rejecting the Committee's recommendations was:

*'because an analysis of what the recommendations would probably raise fell far short of what the Board considered to be an adequate yield for racing in 2011/12.'*<sup>17</sup>

49. The minutes of the Board meeting held on 29 Oct 10, highlight the concerns of Will Roseff in respect of the letter from Paul Lee:

*'He [Will Roseff] wished to point out that, given the Board's responsibility to take into account the balance between the needs of racing and the betting industry's capacity to pay, it would have been more appropriate if the letter<sup>[18]</sup> had also referred to the latter'.*

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<sup>13</sup> Bookmakers' Committee Recommendations for the 50<sup>th</sup> Annual Horserace Betting Levy Scheme.

<sup>14</sup> An Economic Impact of the British Betting Industry, Deloitte, January 2010.

<sup>15</sup> Source: Satellite Information Services Ltd

<sup>16</sup> See paragraph 51.

<sup>17</sup> See Enclosure 2.

It is further recorded that:

*'He [Will Roseff] felt that it was beholden on the Board to take into account the capacity to pay as well as the return to racing and to state clearly why the Bookmakers' Committee Recommendations were not acceptable'.*

### **The Parallel Process**

50. Out-with the statutory process and as had been agreed by the Board previously, Racing submitted in March its assessment of what it considered to be its reasonable needs. This proffered a figure within the range £130m to £150m.

51. Thereafter the Committee and Racing made further submissions to the Board's Executive for consideration by Board members.

- A list of the documents submitted by the Committee to the Board's Executive is at **Annex A**.

52. Additionally, the GAM commissioned Deloitte LLP to assist them. Deloitte LLP undertook an in-depth and wholly independent assessment of the submissions made by the Committee and Racing.

### **Other factors**

53. Other factors that have influenced the environment leading up to the referral for determination are the future of the Tote, the proposal to remove of the Secretary of State from determinations (wef 51<sup>st</sup> Levy Scheme) and the mechanism to replace the Secretary of State's role.

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<sup>[18]</sup> Ibid.

## **GAM METHODOLOGY**

54. The Committee rejects the methodology upon which the GAM base their submission.
55. The GAM submission appears to be influenced more by a desire to repair the Board's balance sheet than the statutory balance to be struck between Bookmaking and Racing. Bookmakers are being asked to pay for historic failures of the Board which during the period 2006 to 2010 spent £57.35m more than was received in Levy.
56. Furthermore, the GAM submission is focussed exclusively, incorrectly, on yield. This is either to entirely misunderstand the Levy process and its methodology, or evidence of an unwillingness to accept it. The GAM submission is unduly influenced by the idea of an indicative yield and as a result the analysis is weak and in many respects irrational.
57. The GAM submission lists the perceived impact of declining Levy yield on racecourses, but fails to balance this with wider economic and social considerations; particularly the declining profits and increasing taxes on bookmakers. No objective assessment has been undertaken to independently assess the requirement for the current number of racecourses to provide a thriving racing industry in Britain, nor has an assessment been made of how continued subsidy through the Levy of uneconomic courses is damaging Racing.
58. The GAM submission fails to demonstrate that Racing has a realistic and genuine 'need' when viewed against the background of a c.4% increase year on year in racecourse attendances, stability of numbers of horses in training, over-subscription of runners to even the most 'low-grade' of races and the profitable status of some of its key elements (e.g. Racecourses). Racing is neither in crisis nor does it need the increased level of funding that would be achieved by radical changes to the Levy mechanism extant, recommended in the GAM submission.
59. Bookmakers however, continue to face significantly increased TV picture rights payments (which continue to bring increased benefit to Racing) which came about in 2008 (an issue that was not resolved during the determination of the 47<sup>th</sup> Levy Scheme and has remained unresolved since), the reducing relevance of British horseracing to the betting customer and the wider effects of the economic downturn. It is clear from the GAM submission that little or no account was taken of the capacity of bookmakers to pay in general nor of the effect their proposals would have on, in particular, those LBO which already generate only low or very low levels of profit on British horseracing.
60. The GAM, who should take an independent view, have not benefitted from robust data or a business case from Racing. Racing's financial submission has been criticised by Deloitte LLP in their independent report, but overall the GAM submission is influenced by Racing's high level lobbying around its alleged crisis; by their own admission the GAM have not been entirely led by objective evidence or data.<sup>19</sup>

### **50<sup>TH</sup> Levy Scheme Target Yield**

61. The Committee rejects the use of 'target yield' as the basis from which a Levy Scheme is subsequently generated.
62. The GAM submission states:

*'The target yield for the 50<sup>th</sup> Levy Scheme is in the region of £75m to £80m'.<sup>20</sup>*

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<sup>19</sup> GAM submission paragraph 13.

<sup>20</sup> GAM submission paragraph 15.

It is not the role of the Board to fix the amount of Levy paid each year by bookmakers but, if possible, to reach agreement with the Committee on the rates, terms, conditions and definitions to be applied during the following year's Levy Scheme. The GAM, in seeking to establish a 'target yield' and then reverse engineer the creation of a Scheme which would, using information provided to them by the Board's Executive generate that 'target yield', which will disproportionately increase Levy monies to which Racing seems to believe it is entitled, have acted out-with the limit of the statute.

63. Until the Levy is replaced by a commercial arrangement, it must be taken for what it is: a compensatory mechanism, defined by statute, to make up for the anticipated reduction in gate receipts following deregulation in the 1960s. It must be remembered that the Levy is not a payment for a British horseracing product and by statute remains unrelated to any perceived commercial value of British horseracing to bookmakers. To set a 'target yield' is, by default, an attempt to establish a price for a product, which, in essence, suggests a commercially-based relationship - which the Levy is not.

64. By definition, such a mechanism whether it be statutory or otherwise does not support an argument to establish a target yield. This was re-iterated by the Board Executive in papers to the Board as recently as 24 Jun 10, in which it stated:

*'The Levy is not a target figure, however useful that may be, it is a mechanism based on gross profits.'*

65. Even if it were the case that 'target yield' was the prime driver of a Levy Scheme, a sum of £75-£80m ignores prevailing social and economic factors and the 2011 budget set by the Board of £60m to meet its requirement. Given the step change in payments for, and receipts from, TV picture rights since 2008, and the anticipated 2012 increase which will affect 3 months of the 50<sup>th</sup> Levy Scheme, the major racecourse groups will be unjustly enriched even at this level of Levy yield.

66. The amount generated by a Levy Scheme is not, and cannot be, fixed. Nor can it be placed within a bounded range. This is because it is entirely dependent upon the profitability of British horserace betting activity. This profitability in turn depends on British horseracing's popularity with the betting customer, the public's desire to spend its leisure pound in this way and the results of races.

67. The language of the statute instituting the Levy sets out the mechanism by which a Levy is to be devised and created. It does not refer to a certain sum being paid from Bookmaking to Racing, and from the start recognises the fluctuating fortunes of competitive markets by reference to the fact that it needs to reflect the capacity of bookmakers to pay; increased bookmaker profits *on* British horseracing result in increased Levy generated *for* British horseracing and vice versa.

68. It is inappropriate for the GAM to found their submission on a framework that seeks to reflect a commercial relationship. As a subsidy it is important that the Levy is not transformed into something other than what the statute or Parliament intended, especially given its impact on a range of internationally competitive businesses.

69. The Committee agrees that:

*'There is no scientific basis for determining a target yield; rather independent judgement is critical and fundamental'.<sup>21</sup>*

Whilst in no way supporting the premise of setting a 'target yield', the Committee would welcome independent assessment and external audit of the methodology upon which the GAM submission is based.

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<sup>21</sup> GAM submission paragraph 13.

## Other Observations

70. The GAM submission states that:

*'The structure of horseracing and thoroughbred breeding in Britain should not be put at further risk.'*

*'The cornerstone of horseracing is the preparedness of owners to keep buying horses and paying training fees and entry fees and of breeders to continue thoroughbred breeding.'*

*'Prize money is an essential feature, because it lubricates the structure of horseracing and enables it to function.'*

Such a basis for assessment highlights the misplaced dependency of Racing upon the Levy, a government facilitated subsidy, which leads it to believe that it can and should exist out-with the harsh economic reality experienced by other sports, industries and employers, including bookmakers.

71. It is the view of some that one of the key functions of Levy monies is the provision of prize money to *'lubricate'* the structure of horseracing. The underlying assumption that bookmakers should foot the bill from their reducing profits from British horseracing is without basis. Given the significantly enhanced financial position of the major racecourse groups and courses, it is clear that they are well-equipped to provide a greater contribution to prize money and to fill such reductions as may arise from the decline in Levy income.

72. Any assessment in terms of Racing's reasonable needs, the surrounding economic and social factors and bookmakers' ability to pay, should be confined to a consideration of the contribution that British horseracing makes to LBO and other categories of UK-based bookmaker. Racing's popularity both in the LBO and amongst the general public continues to decline. It defies logic to suggest that bookmakers should pay an increased level of hypothecated tax on a product whose cost base is increasing and whose contribution to revenue is declining.

73. The Committee is concerned at the apparent presupposition of the GAM that the *'headline rate should be reconsidered'* if changes were made to Levy income flows following resolution of *'users of betting exchanges'* and *'offshore betting operators'* factors. The Committee considers it impractical to implement any changes mid-Scheme (however they may be derived or generated) and note that unless directed by Government, it is the remit of the Committee to recommend annually a Scheme (which includes the headline rate) to the Board.

74. The GAMs report is also selective in its approach and they have failed to fully follow their own stated principles for decision making. It is clear from the construction of the GAMs submission that they have also allowed themselves to be wrongly influenced by the idea that bookmakers should be compensating Racing for the reduction in Levy as a result of offshore migration. This is a distinct and separate issue which is simply not within the scope of this determination.

## **THE GAM RECOMMENDATION**

75. The Committee rejects the GAM recommendation presented.

76. The GAM have made a recommendation to recession-proof Racing and remove any incentive for Racing to make fundamental changes or move to agree a commercial solution with bookmakers, with no regard for the effect on bookmakers or their capacity to pay.

77. The GAM have produced a solution that causes major financial disadvantage to smaller bookmakers (the abolition of thresholds increases Levy payments by up to 800% for some bookmakers) and is irrational in its application (allowing British horseracing to enjoy the benefit of bookmaker's profits from foreign racing- a product over which British horseracing has no control nor does it make any contribution to its cost base) on the basis of the flawed notion of 'convoyed sales'.

78. The Committee's recommendations are the balanced result of consultation and discussion with all types and sizes of bookmakers. The GAM have chosen to ignore these recommendations, and suggest a radically different Levy Scheme which reflects their lack of knowledge of the bookmaking industry and disregards the advice given to them by bookmakers' representatives, industry subject matter experts and professional advisors.

### **Abolition of Thresholds**

79. No credible argument has been made to remove, reduce or re-structure the relief afforded in each Levy Scheme to protect lower profitability LBO via the use of thresholds and no justification exists to do so.

80. The statute has provided since its passing in to law, a mechanism for bookmakers to be divided into different categories for the purposes of assessing their liability to pay the Levy. It is a fundamental feature of the statute and the responsibility for recommending the different rates, categories and definitions for each Levy Scheme remains with the Committee. Every Levy Scheme to date has made such provision to a significant extent, usually, as in the 2002 Determination, at a level considerably higher than that prevailing in the 49<sup>th</sup> Levy Scheme or in our proposals for the 50<sup>th</sup> Levy Scheme.

81. The importance of LBO to the Levy cannot be overstated, nor can the negative effect of removing such relief as is extant. The Committee sees no reason at this stage to change a mechanism whose current structure is the most appropriate and does not believe it is possible to better reflect the differing costs, and thus capacity to pay, of different classes of bookmakers.

82. An advantage of the threshold system is that it incentivises Racing to become more attractive to betting customers, because the marginal rate of Levy is in excess of the headline rate. This is because increasing a shop's gross profit from horseracing will increase the rate payable.

83. In the OCP report dated 21 Jan 08, commissioned by the Minister for Sport to assist him in the determination of the 47<sup>th</sup> Levy Scheme, there was clear recognition of the importance of the threshold system:

*'We therefore suggest that the threshold be indexed for inflation and, if a lower levy yield is adopted, consideration be given to increasing the threshold by an appropriate amount as opposed to each basis point reduction in the rate.'*



It also stated:

*'Restoration of the real 2002-3 value of the threshold would be consistent with the 2002-3 determination. It would take into account the capacity to pay of each bookmaker considered separately. It would almost certainly prevent the closure of a number of small shops, probably preserving betting shop facilities in some areas where they would otherwise cease.'*

84. The threshold for the 41<sup>st</sup> Levy Scheme was set by the Secretary of State at £150,000. Allowing for annual increases in the rate of RPI since that date, the threshold figure would now be £190,118.<sup>22</sup>

85. LBO generated 72% of the total Levy achieved under the 48<sup>th</sup> Levy Scheme. Those LBO currently in business are now contributing to Racing. If more were to close due to a reduction or removal of the threshold, the burden of supporting British horseracing would fall on the remaining LBO, which would in turn make even more LBO uneconomic. If an attempt to make-up for the Levy lost due to closures were imposed upon the LBO remaining, the result would be a downward spiral of diminishing return for the Levy. It is without doubt that such actions would have significant effect.

86. The Levy yield from a closed LBO is £0 which, on closure, also ceases to pay for TV pictures. Some of the business from that shop may move to another leviable LBO but, especially where the shop is at some distance from the nearest competitor, it may be lost altogether if the customer stops betting, moves to an unlicensed operator, or to an on-line provider – many of which are based off-shore.

87. In making a recommendation to the Secretary of State, the GAM have a responsibility for the result of their actions/recommendations. The GAM submission fails in this regard, particularly in respect of the effect that imposition of such recommendations would have on operators of less profitable LBO.

88. As the Committee has previously identified to the Board, the forecast reductions in LBO for CY 11, based on a 'rollover' of the 49<sup>th</sup> to the 50<sup>th</sup> Levy Scheme (and therefore not subject to any Levy generated reductions) it is likely that c.72 shops will close.<sup>23</sup>

89. At the request of the Committee, RS Business Modelling (RSBM) modelled the effect of imposing a Levy Scheme with a headline rate of 9.0% without abatements (removal of thresholds) and the re-introduction of foreign racing.<sup>24</sup> (Note: Yields are indicative of only those elements modelled and not total yield).

90. RSBM is one of the country's leading experts on the UK gambling sector with over 15 years of consulting experience. The RSBM model is based upon an industry survey that uses sector experience to gross up the data to provide industry estimates for revenues, costs, profits, employment and taxes. The 2008 RSBM Report for the Association of British Bookmakers was presented to, and accepted by, HM Treasury to provide respected estimates of historic impacts of change and for generating possible future scenarios.

91. For the four most vulnerable groups (see below) the effect of the GAM recommendation is particularly severe. For example, the Single LBO Operators would have their average net profit reduced from £2,320 to £900 on average. It is reasonable to assume that such a change to the Levy would significantly impact upon operators. The figure quoted is an average per shop and therefore a standard distribution would leave many LBO likely to close.

92. When compared against the 'Base' year used in RSBM reports<sup>25</sup> it can be reasonably assumed that:

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<sup>22</sup> Source: Ernst & Young (as at May 2010)

<sup>23</sup> Source: Satellite Information Services Limited.

<sup>24</sup> See Enclosure 3.

<sup>25</sup> See Enclosure 4.

- 15% of Large and Small Independent LBO would close.
- 17.5% of Single LBO Operators would close.
- 10% of the Big 5<sup>26</sup> Very Small LBO would close.
- 2.5% of the Big 5 Small LBO would close.
- 344 LBO would close.
- This is in addition to the 72 LBO expected to close under 'rollover' conditions.
- A total of 416 LBO would close with the total loss of c. 2000 jobs.

93. Economic modelling conducted on behalf of the Association of British Bookmakers (ABB)<sup>27</sup>, and generally accepted by HM Treasury as reliable industry data, shows that for every £10 million pounds increase in costs (Levy or other taxation) some 200 LBO and 1000 jobs would be put at serious risk.

94. The same modelling also demonstrates the importance of the Very Small and Small LBO of the Big 5 and all Independent and Single LBO Operators. In 2009 these accounted for 49.6% (39.0%)<sup>28</sup> of LBO, 38.2% (27.0%) of income, 20.5% (10.9%) of profit, 40.2% (33.0%) of employment and 37.6% (28.0%) of taxation.

95. Furthermore the ABB data shows that the Very Small LBO owned by the Big 5 and those LBO owned by the Independents and Single LBO Operators make profits, on average, of less than £17,600. These LBO, which account for 27.1% (23.6% 2008) of the total LBO estate, are very vulnerable. These LBO employ approximately 9,795 staff.

96. **Table 2** shows how the GAM recommendation inflicts the largest increases in Levy on the smallest LBO. No evidence is presented by the GAM to suggest that since the 49<sup>th</sup> Levy Scheme was agreed the capacity to pay of small LBO has increased. Similarly no evidence has been presented to suggest that LBO with a British horseracing gross profit of less than £70,000 per annum can afford an increase of over 30% in Levy payments.

**Table 2**

LBO - British Horseracing Gross Profit	Bookmakers' Committee Recommendation	GAM Recommendation
10,000	-28%	838%
20,000	-28%	369%
30,000	-28%	213%
40,000	-28%	134%
50,000	-28%	88%
60,000	-28%	56%
70,000	-28%	34%
80,000	-28%	17%
90,000	-27%	6%
100,000	-19%	6%
110,000	-11%	6%

<sup>26</sup> Betfred, Gala Coral, Ladbrokes, Tote and William Hill.

<sup>27</sup> RS Business Modelling.

<sup>28</sup> 2008 data in brackets.

120,000	-2%	6%
130,000	0%	6%
140,000	0%	6%
150,000	0%	6%
160,000	0%	6%
170,000	0%	6%
180,000	0%	6%
190,000	0%	6%
200,000	0%	6%

97. Of particular note is the effect that the Scheme recommended by the GAM has on those LBO least able to pay which would result in increases of over 800% for those operators of the least profitable LBO.

98. **Table 3** illustrates the real and quantifiable effect of the GAM recommendation on a company which operates smaller LBO. This table compares the actual Levy paid under the 48<sup>th</sup> Levy Scheme (the most up to date complete Scheme) by H Backhouse (Baker Street) Ltd. with that which would be due under the GAM recommended Scheme for the 50<sup>th</sup> Levy. Levy paid on British horseracing would increase by £24,653 (77.59%).

**Table 3**

H Backhouse (Baker Street) Ltd - 2009/10 Levy return for all 11 shops that were open for the full year											
Shop	Total OTC GP	Default UKHR		Levy		Default UKHR		Levy		Increase in Levy	
		%	£	%	£	%	£	%	£	%	£
1	61,867	43%	26,602	2.95%	785	50%	30,934	9.00%	2,784	254.76%	1,999
2	72,364	43%	31,116	3.45%	1,074	50%	36,182	9.00%	3,256	203.34%	2,183
3	84,835	43%	36,479	4.05%	1,477	50%	42,418	9.00%	3,818	158.40%	2,340
4	88,062	43%	37,866	4.20%	1,590	50%	44,031	9.00%	3,963	149.17%	2,372
5	105,753	43%	45,473	5.05%	2,296	50%	52,877	9.00%	4,759	107.23%	2,462
6	109,694	43%	47,168	5.24%	2,472	50%	54,847	9.00%	4,936	99.72%	2,465
7	128,146	43%	55,102	6.12%	3,372	50%	64,073	9.00%	5,767	71.00%	2,394
8	141,430	43%	60,815	6.75%	4,105	50%	70,715	9.00%	6,364	55.04%	2,259
9	152,164	43%	65,430	7.27%	4,757	50%	76,082	9.00%	6,847	43.95%	2,091
10	154,714	43%	66,526	7.39%	4,916	50%	77,357	9.00%	6,962	41.61%	2,046
11	154,886	43%	66,600	7.40%	4,928	50%	77,443	9.00%	6,970	41.42%	2,041
	<b>1,253,915</b>		<b>539,177</b>	<b>5.89%</b>	<b>31,773</b>		<b>626,958</b>	<b>9.00%</b>	<b>56,426</b>	<b>77.59%</b>	<b>24,653</b>

99. At the request of the Committee, the Board Executive has now provided data<sup>29</sup> that illustrates further the effect of implementation of the GAM recommendation to the Secretary of State:

*'Between 2893 (36%) and 3326 (41%) LBO will pay at least 50% more levy than they did under the most up to date completed scheme (48<sup>th</sup> Levy Scheme).*

*Between 1552 (19%) and 1818 (22%) LBO will pay at least 100% more levy than they did under the most up to date completed scheme (48<sup>th</sup> Levy Scheme).*

- *Uses information from an assumed 95% of LBO*

<sup>29</sup> 16 Dec 10.

- Assumes total gross profit on foreign racing of £135,000,000.
- Assumes foreign racing will be distributed across all LBO in proportion to their gross profit on British horseracing in the 48<sup>th</sup> Levy Scheme.
- Assumes GAMs estimated range of £76m (low) to £82m (high)'.

100. It is of significant concern that these calculations had not been carried out prior to the GAM submitting their recommendations to the Secretary of State on 30 Nov 10. That they failed to do so supports our contention that, in formulating their proposals, they paid scant regard to the principle of capacity to pay and the effects that their proposals would have on different parts of the bookmaking industry.

### **Re-introduction of a Levy on Foreign Racing**

101. Racing has no rights over foreign racing, makes no contribution towards the staging of events elsewhere or to the costs of acquisition. There is, in short, no connectivity between British horseracing and racing which takes place overseas and thus no basis upon which to claim a levy income from it. There is not now, nor in the view of the Committee has there ever been, any justification for a statutory levy on foreign horseracing.

102. The GAM submission uses Ireland as the closest funding model to British horseracing stating that Ireland include foreign racing; this is misleading. Ireland employs a 1% turnover betting duty in the high street which applies to all forms of betting (horses, dogs, numbers et al); the Irish government then gifts this tax to the Horse and Greyhound fund.

103. The GAM submission also fails to take account of payments currently made by leviable bookmakers which are equivalent to a levy, directly to the organisers of foreign racing, based on the operator's profits from such events. Consequently, the imposition of levy on foreign racing would result in a form of double taxation.

104. Nevertheless, the GAM submission recommends the re-introduction of a levy on foreign racing. With effect from the 42<sup>nd</sup> Levy Scheme, the Levy on foreign racing was discontinued following a negotiation with the then BHB that the threshold should be halved from £150,000 to £75,000. At no point in the discussions surrounding the 42<sup>nd</sup> Levy Scheme was the exclusion of foreign racing questioned because it was recognised that the BHB had no locus in this area. During the formal drafting of the 42<sup>nd</sup> Levy Scheme specific reference was made to only British horseracing business. That has been the position ever since.

105. The GAM submission fails to acknowledge the link between the halving of the threshold and the discontinuation of the Levy on foreign racing as part of the 42<sup>nd</sup> Levy Scheme.

106. In a letter dated 15 Oct 03, Mr Warwick Bartlett, Committee Chairman, wrote to Mr Peter Savill, BHB Chairman, stating:

*'The BHB representatives on the Levy Board will be aware that, each year and for many years, the Bookmakers' Committee has argued at the Annual Strategy Review that foreign racing should be exempt from the levy. It did so because there is no moral or commercial reason why British racing should enjoy the benefit of a product which it does not stage nor to which it makes any contribution at all and which is, in any case, paid for at source by the betting industry. However, this view was not shared by a majority on the Board so foreign racing remained leviable until the 42<sup>nd</sup> scheme, when it was, quite correctly, exempted for reasons to which I will return'.*

107. It is correct that no distinction is drawn in the 1963 Act between betting transactions on races which take place in Great Britain or elsewhere. However, when the Act was drafted, there was no racing available to British betting customers at that time except that which took place in Great Britain, nor was it envisaged by legislators that it would be; Hansard makes no reference to any discussion on such a possibility. It is not, therefore, surprising that the Act draws no distinction between something which existed at the time it was drafted and something which did not. Furthermore, as the Board acknowledges on its website, the original purpose of establishing the Levy was to provide a means of compensating racecourses for the loss of attendance which was anticipated when the LBO were legalised in 1961. This clearly has nothing whatsoever to do with racing which takes place overseas, then or now, and, in our view, effectively confirms what the legislators of the day had in mind.

108. In their submission, the GAM argue that there is a clear consumer demand for foreign horseracing which, given its greater availability, has increased. They go on to observe that:

*'it does seem fair to conclude that British horseracing is a driver of any interest from British-based customers, yet British horseracing receives no benefit from it and, indeed, it acts as a competitor to it. It has probably got to the state that it is more attractive for bookmakers to market and persuade their customers to bet on foreign horseracing now rather than British horseracing especially with two picture providers (SIS and TurfTV) providing competing services. An Irish race, for example, which may feature horses and jockeys familiar to British punters, incurs no Levy whereas a British race does. This obviously penalises British horseracing.'*

109. One major factor that has driven the increase in foreign racing is, indeed, the introduction by racing interests of Turf TV. Prior to that occurring, the single supplier, SIS, prioritised British horseracing, generally only providing overseas content when there were gaps in the British horseracing programme, or it had finished for the day. Now that TurfTV is operating, both suppliers have blanks in their programmes which they have to fill. By introducing the second channel in order to force bookmakers to pay more for pictures, Racing has once again contributed to its own disadvantage in the context of the Levy and if its income from that source is 'penalised' as a result, then it has only its own policies to blame.

110. It is bizarre to propose, as the GAM submission does, that bookmakers should be required to pay even more to make up for this self-inflicted loss. It is misleading to claim that British horseracing is a driver of interest for British based customers in foreign racing and that there is any relationship between the two offerings. There is no evidence whatever to support that view which is, in any event, counter-intuitive.

111. Deloitte LLP in their advice to the GAM state:

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

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

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

112. Notwithstanding the recommendation within the GAM submission to abolish thresholds, which we reject, foreign racing could not be re-introduced without the agreement of the Committee (or by determination by the Secretary of State) and without addressing the issue of threshold level. The GAM desire not to address the issue by abolishing thresholds is, in our opinion, untenable. The threshold was halved under the 42<sup>nd</sup> Scheme to compensate for loss of Levy from this source and, if foreign racing was once again to become 'leviable' the balance would have to be restored.

#### **Reduction of Headline Rate to 9%**

113. If evidenced as the only change to the terms of the 49<sup>th</sup> Levy Scheme, this reduction would achieve a similar effect to raising the threshold to £123,000 as recommended by the Committee in Jul 10. Such a change would acknowledge the bookmakers' reduced capacity to pay which has been generated by the significant increase in TV picture rights payments since 2008 and the relatively poor performance of British horseracing as a contributor to bookmaking industry profits. It is of note that the proposed increase in threshold to £123,000 contained in the Committee's recommendations is a more equitable method of providing relief across the entire LBO estate.

114. However, included as it is to give the appearance of providing relief to bookmakers, irrespective of type and size, it fails. The relief provided in no way compensates for the effect of the re-introduction of foreign racing and the removal of thresholds.

## **50<sup>TH</sup> LEVY SCHEME FORECAST, MODELLING AND ASSUMPTIONS**

115. The Committee rejects the assumptions upon which the forecasts for the 50<sup>th</sup> Levy Scheme contained within the GAM submission are based.

116. The assumptions and modelling within the GAM submission undermines the recommendation made therein as it is based on significantly underestimated potential yields. The Board Executive forecasts for ‘low yield’ and ‘high yield’ scenarios for the 50<sup>th</sup> Levy Scheme are overly pessimistic.

117. The Board Executive has based its modelling of the 50<sup>th</sup> Levy Scheme on its own assessment of the yield for the 49<sup>th</sup> Levy Scheme. It has assumed, for its ‘low yield’ scenario, a repeat of the anomaly that occurred during FY10/11 Q1.<sup>30</sup> Using such ‘continuance’ of the expected outturn of the 49<sup>th</sup> Scheme (£65-£70m) as a mechanism to establish the likely yields for the 50<sup>th</sup> Scheme is completely wrong and an incorrect basis for assessing the outturn of the 50<sup>th</sup> Levy Scheme.

118. To create a model that provides a realistic yield for the 50<sup>th</sup> Levy Scheme, a hypothetical 49<sup>th</sup> Levy Scheme must be employed to reflect statistical/normal reductions to act as a basis for calculation.

119. We also reject certain other assumptions made by the HBLB Executive in respect of the modelling of the 50<sup>th</sup> Levy Scheme shown at **Annex B**.

120. At **Annex C**, the Committee incorporates into the Board Executive modelling, assumptions that are more reasonable and therefore more likely to produce a realistic forecast for the yield of the 50<sup>th</sup> Levy Scheme.

121. When applied to the 6 scenarios considered for the 50<sup>th</sup> Levy Scheme the forecast yields are as outlined in the tables below:

### **HBLB Assessment**

	Bookmakers’ Committee Recommendation	Rollover	GAM Option A	GAM Option B	GAM Option C	GAM Option D
Low Yield	£50m	£58m	£76m	£75m	£76m	£75m
High Yield	£57m	£65m	£82m	£80m	£83m	£84m

### **Bookmakers’ Committee Assessment**

	Bookmakers’ Committee Recommendation	Rollover	GAM Option A	GAM Option B	GAM Option C	GAM Option D
Low Yield	£58m	£66m	£83m	£81m	£84m	£86m
High Yield	£61m	£69m	£85m	£83m	£86m	£89m

<sup>30</sup> The abnormally low Gross Profit for bookmakers Apr-Jun 10 was due to a series of ‘catastrophic’ results at Ascot and Aintree.

## **GAM EXPLANATION FOR RECOMMENDATIONS**

### **Recent History of the Levy**

122. The Committee endorses the 'Actual' figures presented in the table.
123. It is of note that during the period 2006 to 2010 the Board's total expenditure was £57.35m in excess of the Levy received.
124. The Committee believes that the 49<sup>th</sup> Levy Scheme will yield between £65m and £70m.
125. The Committee disagrees strongly with the Board's forecast for the likely yield from the 50<sup>th</sup> Levy Scheme if a 'rollover' were to be determined. The Committee believes such a Scheme would yield between £66m and £69m<sup>31</sup>. Board Executive modelling has been discussed at paragraphs 115-121.
126. The Committee agrees that it is prudent for the Board to set a budget of £60m for CY 2011.

### **Forecasting**

127. The Committee is extremely concerned about the inference within this section. The opening sentence is incorrect:

'HBLB sets its annual budgets having regard to the best available information provided by the Bookmakers' Committee'.

128. The Committee now does this but did not for the period 2007-2010.<sup>32</sup> During the period 2007-2010 the Board's Executive obtained information direct from certain bookmakers. The Committee has no knowledge of the size of sample used by the Board's Executive or the accuracy of the information, and is unsighted on the methods used by the Board Executive to produce its own in-house forecasts which it subsequently presented to the Board.

129. It is indeed correct that budgets would have been set within Board meetings attended by the Committee Chairman and the nominated observer. This amounts to 1 of 8 votes. Repeated references of:

*'this was agreed by the Bookmakers' Committee representatives'*

appear little more than an attempt to shift/focus 'blame' on one individual who was out-with the mechanism by which the Board Executive generated its own internal forecasts.

130. The Committee voting member of the Board was not in a position to judge the severity of the effect of the economic downturn, nor was he able to judge the continued declining interest of British horseracing to the betting customer.

### **Reasons for Recommending a Target Yield of £75m to £80m**

131. The Committee notes the significant attention provided under the section 'Reasons for Recommending a Target Yield of £75m to £80m'. Despite its assertion in a later paragraph that the GAM did not wish to consider the 50<sup>th</sup> Levy Scheme in a context that addresses both a bookmakers' capacity to pay and Racing's needs and instead:

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<sup>31</sup> Paragraph 121.

<sup>32</sup> Re-commenced Jul 10.



‘...rely on, from the 1969 Act and from the Secretary of State’s public law duties, the premise that the secretary of State can examine any matter appearing to him to be relevant to the form or context of the Scheme when determining a Levy Scheme.

the GAM do completely the opposite.

132. This section defines what the GAM perceive to be Racing’s need with no consideration of the bookmakers’ capacity to pay – again contradicting the statements made later on. Further, in doing so, it lists without quantitative evidence, a number of circumstantial and generic arguments not supported by any form of business case.

133. As highlighted previously in this submission, the GAM have in essence adopted Racing’s argument, changed the amounts and ignored the bookmakers’ position entirely.

### **Distribution of Target Yield**

134. For reasons already explained, the Committee rejects the underlying principle of a ‘target yield’. In essence, the concept turns the statutory mechanism on its head.

135. The Committee considers the table presented at paragraph 33 of the GAM submission adds little of direct relevance to the determination process.

### **Bookmakers’ Capacity to Pay and Racing’s Needs**

136. As highlighted at paragraph 131, the GAM submission chooses to put to one side the area of bookmakers’ ‘capacity to pay’ and Racing’s ‘needs’.

137. Racing assessed its ‘reasonable needs’ at between £130 and £150 million. On any objective view this was an unreasonable demand. It is possible however, that Racing set its ‘reasonable needs’ at such a high level in the hope, subsequently realised, that the GAM would adopt a lower, but still excessive, figure. In establishing a ‘target yield’ the GAM submission has contradicted itself and taken upon itself the definition of what it considers to be Racing’s need. Deloitte, in its report commissioned by and for the GAM, concluded that Racing had completely failed to analyse its cost base and income, meaning it was almost impossible to establish its ‘needs’. The Deloitte report states:

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

138. Further, as the establishment of a ‘target yield’ (Racing’s ‘need’) by the GAM is done with no reference to the bookmakers’ capacity to pay, significant imbalance exists in the argument presented.

139. To introduce arguments directed at bookmakers having to demonstrate ‘an incapacity to pay’ is totally at odds with business practice. The GAM submission implies that a bookmaker’s capacity to pay is infinite as long as there is money in the bank, irrespective of how much or from whence it was derived. To approach the argument from a lack of ‘incapacity to pay’ is to suggest that all business related to a particular bookmaker whether he/she has diversified into other areas (ie: bingo or insurance), does not demonstrate an ‘incapacity to pay’ and may therefore be levied to support British horseracing. This is an entirely unreasonable and invalid basis upon which to carry out what is supposed to be an impartial and independent assessment.

140. It is also unreasonable for the GAM to use this approach to bypass the significant effect on bookmakers’ capacity to pay of TV picture rights payments made by bookmakers and received by Racing.

The bookmakers' capacity to pay Levy continues to reduce in-line with the increased, and as yet unaddressed, cost of TV picture rights<sup>33</sup> and the reducing relevance of British horseracing to the betting customer.

### **Payments from Betting to Racing**

141. The Committee notes that the GAM submission excludes sponsorship estimated by them<sup>34</sup> to be in the region of £10m per annum, the Tote's additional contribution to Racing and the sale of TV picture rights abroad and to internet sites etc.

142. The chart on page 13 of the GAM submission shows that (with the exception of 2007/08 which is recognised by all stakeholders as one that benefitted significantly from high-roller losses), the total payments made by Bookmaking to Racing forecast for 2010/11 is only £3m (1.7%) below the average for the 2003/2011 period quoted. This is despite the reduced relevance of British horseracing to the betting customer and the economic downturn.

143. Even on Racing's own, disputed, figures (combining Levy income and TV picture income) used to refute the Committee's case and discounting the exceptional Levy yield in 2007/8, across the racing industry total income has only declined by around £10-£14 million.

144. Paragraph 43 of the GAM submission specifically chooses as a reference point for discussion 2008/9 and states that:

*'The revenues received by racecourses for the sale of picture rights at Table 4 have not changed significantly since 2008/9, but will do so in 2012 on current forecasts.'*

145. Such a start point ignores the as yet unresolved issue of pre 2008 TV picture rights payments, addressed by the Secretary of State in his determination of the 47<sup>th</sup> Levy Scheme. The GAM submission states that between 2006/7 and 2008/9 TV picture revenues received by Racing rose from £33.5m to £50.3m.

146. The GAM submission chooses to ignore in its entirety the massive and immediate 46%<sup>35</sup> increase in direct costs that followed the introduction of TurfTV, the huge injection of capital to Racing that followed from bookmakers (the same, single and tied source as Levy contributions) and most importantly the comments of the Minister in his 47<sup>th</sup> determination relating to the potential for it to be considered at another time. In choosing to ignore this as yet unresolved matter, the GAM fail to act reasonably or responsibly.

147. The Committee believes that the GAM submission fails to address the additional £18m (2009/10) per annum received by Racing (racecourses) since 2008 following the introduction of TurfTV at an estimated additional cost to bookmakers of £29.4m<sup>36</sup> per annum (2009/10).

148. In the past there was clearly an acceptance from all parties that Levy and picture rights costs went hand-in-hand in assessing the overall transfer of funding from Bookmaking to Racing. Also, that it was sensible to ensure picture costs were affordable so that racing could be promoted effectively in betting shops in order to maximise betting shop customer participation in betting on British horseracing (i.e. maintaining its betting market share) and therefore to maximise Levy returns. However, the emergence of upstream competition and fragmentation of supply of pictures has over-ridden this approach and distorted the way in which funds transfer from Bookmaking to Racing.

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<sup>33</sup> Since 2007.

<sup>34</sup> GAM Independent Assessment, Annex A, dated 29 Sep 10.

<sup>35</sup> FY07/08 (£38.4M) to FY08/09 (£56.2M).

<sup>36</sup> Includes VAT. Some VAT is recoverable by some operators.

## **Foreign Racing and Other Products**

149. The Committee notes the GAM observation in respect of 'Foreign Racing and Other Products'.

150. It is the position of the Committee that all non-British horseracing betting activity is by definition encompassed within 'Other Products' and is out-with the scope of the Levy. The Committee rejects the GAM position that there is a linkage between betting on British and foreign horseracing and no evidence of 'convoys sales' exists to support the link which they try to establish.

151. Foreign horseracing is addressed specifically at paragraphs 101-112.

## **Betting Exchanges**

152. The Committee notes the GAM observation in respect of Betting Exchanges.

## **Offshore Operators**

153. The Committee notes the GAM observation in respect of Offshore operators.

## **Turnover (TO) v Gross Profit (GP)**

154. The Committee notes the GAM observation in respect of TO vs GP. A GP Scheme is the most appropriate measure to use within the Levy mechanism. This is a position which the Committee will continue to hold.

155. The Deloitte report states:

*'We note that Racing proposes a return to Levy based on turnover rather than gross win which it argues is more predictable, less subject to fluctuation and more within the influence of Racing. We consider that gross win is a better measure of Bookmakers' capacity to pay than turnover,...'*

## **Guarantee and Cap**

156. The Board could not formally administrate a guarantee and cap of between £75m and £80m, but the GAM submission encourages the Committee to put forward such a proposal. The Committee believes this displays a lack of confidence in the logic and legality of the GAM recommendation and is aimed at manufacturing a situation where the large bookmaking operators underwrite a guaranteed settlement.

157. Such a settlement would mean the large bookmaking operators subsidising the independents (which is a distortion of competition) and would mean that the largest bookmaking operators would be paying a hypothecated tax at a greater rate. Even if the large bookmaking operators were minded (and able) to underwrite a figure, the £75m-£80m sum is excessive when compared to Racing's 'need' addressed by the Board's currently budgeted expenditure of £60m in 2011. A guaranteed sum would also discourage Racing from adopting a commercial approach or improving the betting shop product.

## **CONCLUSIONS**

158. Determination of the 50<sup>th</sup> Levy Scheme is affected by many as yet unresolved and highly significant issues. They are:

- TV picture rights increases since 2007/2008.
- The anomalous effect of the 49<sup>th</sup> Levy Scheme.
- The disputed forecasts of the 50<sup>th</sup> Levy Scheme.
- The Betting Exchanges Consultation.
- Off-shore operators.
- The sale of the Tote.
- The removal of the Secretary of State from determinations (wef 51<sup>st</sup> Levy Scheme).
- The mechanism to replace the Secretary of State's role.
- The long-term future of the Horserace Betting Levy.

159. It is clear that many of the highly complicated and directly relevant issues outlined at paragraph 158 shall not be resolved in time for the start of the 50<sup>th</sup> Levy Scheme. It is likely however, that they shall all be resolved prior to the start of the 51<sup>st</sup> Levy Scheme.

160. In light of these impending changes and the uncertainty which necessarily surrounds them, the Secretary of State may decide it is appropriate to await the outcome and conclusion of all relevant associated matters outlined at paragraph 158 and direct they be addressed under the mechanism that is likely to replace his involvement in time for the adoption of the 51<sup>st</sup> Levy Scheme.

161. Should the Secretary of State decide on this course of action, the Committee would suggest that notwithstanding its assertion re TV picture rights payments, consideration be given to a determination which directs a rollover of the 49<sup>th</sup> Levy Scheme with appropriate adjustments for RPI where applicable. As discussed above, the Committee does not accept that this outcome would result in the serious shortfall in Levy income which the GAM have predicted. The Committee would however, be very willing to engage with Ministers and officials as necessary to discuss this option in greater detail.

**DOCUMENTS SUBMITTED BY THE COMMITTEE TO THE BOARD EXECUTIVE**

1. Bookmakers' Committee Recommendations for the 50<sup>th</sup> Annual Horserace Betting Levy Scheme.
2. Bookmakers' Committee response to Racing's Submission to the Horserace Betting Levy Board.
3. Ernst & Young, '50<sup>th</sup> Horserace Betting Levy Scheme, Report for the Bookmakers' Committee'.
4. Ernst & Young, '50<sup>th</sup> Horserace Betting Levy Scheme, Critique of the Submission of British Horseracing'.
5. London Economics, 'An assessment of economic arguments presented in relation to the setting of the 50th Horserace Betting Levy'.
6. Bookmakers' Committee response to 'Racing's Initial Critique of Bookmakers' Committee Recommendations'.
7. Ernst & Young '50<sup>th</sup> Horserace Betting Levy Scheme, Report for the Bookmakers' Committee - Analysis Update'.
8. Bookmakers' Committee response to 'GAM Independent Assessment(IA)'.
9. RS Business Modelling, 'An analysis of GB Horseracing Levy Scenarios'.
10. RS Business Modelling, 'An analysis of GB Horseracing Levy – Extra Scenarios'.
11. Letter from Will Roseff to Paul Lee – British Horseracing TV Costs.
12. Bookmakers' Committee response to Racing's 'Turnover Paper' (including response to GAM IA Turnover question).
13. Exchange of Letters between Will Roseff & Penny Boys re Thresholds.

**HBLB 50<sup>TH</sup> LEVY SCHEME FORECAST, MODELLING AND ASSUMPTIONS**

The 2 scenarios modelled by HBLB are as follows:

Scenario A forecasts a **'low yield'** decline from 48<sup>th</sup> – 50<sup>th</sup> Levy Scheme. The forecast yield for the 49<sup>th</sup> Levy Scheme is £65m.

	LBO	Telephone	Internet	Exchanges	Other
48 <sup>th</sup> to 49 <sup>th</sup> Scheme	-9.0%	-2.2% <sup>1</sup>	-53.8% <sup>3</sup>	-5.0%	-12.0%
49 <sup>th</sup> to 50 <sup>th</sup> Scheme	-4.5%	-34.0% <sup>2</sup>	-8.0% <sup>4</sup>	-5.0%	-10.0%

<sup>1</sup> This assumed decline comprises 3 elements a) WH telephone business moved off-shore Nov 10 b) a 20% reduction in profits of telephone betting for firms remaining on-shore c) a positive correction to account for anomalous activity.

<sup>2</sup> This assumed decline comprises 2 elements a) direct effect of WH located off-shore b) a 20% reduction in profits of telephone betting for firms remaining on-shore.

<sup>3</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) a 3% reduction in profits of internet betting for firms remaining on-shore.

<sup>4</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) an 8% reduction in profits of internet betting for firms remaining on-shore.

Scenario B forecasts a **'high yield'** decline from 48<sup>th</sup> – 50<sup>th</sup> Levy Scheme. The forecast yield for the 49<sup>th</sup> Levy Scheme is £70m.

	LBO	Telephone	Internet	Exchanges	Other
48 <sup>th</sup> to 49 <sup>th</sup> Scheme	-4.5%	-15.0% <sup>5</sup>	-53.8% <sup>7</sup>	-2.6%	-6.0%
49 <sup>th</sup> to 50 <sup>th</sup> Scheme	-0.9%	-34.0% <sup>6</sup>	-8.0% <sup>8</sup>	-5.0%	-10.0%

<sup>5</sup> This assumed decline comprises 3 elements a) WH telephone business moved off-shore Nov 10 b) a 6% reduction in profits of telephone betting for firms remaining on-shore c) a positive correction to account for anomalous activity.

<sup>6</sup> This assumed decline comprises 2 elements a) direct effect of WH located off-shore b) a 20% reduction in profits of telephone betting for firms remaining on-shore.

<sup>7</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) a 3% reduction in profits of internet betting for firms remaining on-shore.

<sup>8</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) an 8% reduction in profits of internet betting for firms remaining on-shore.

**Methodological Assumptions**

The Committee notes the methodological assumptions used by the Board's Executive and the modelling errors likely to be introduced as a result.

- Banding LBO used by HBLB in modelling used only 5 groups.
  - 'Big 3' (Gala Coral, Ladbrokes and William Hill).
  - Betfred & Tote.

- Small chains with more than 30 shops.
- Small chains with fewer than 30 shops.
- Single shops.
- Based on Forms of Declaration (FoD) received by HBLB for 48<sup>th</sup> Levy Scheme.
  - Does not take account of shops that were open only part year.
  - Assumes FoDs outstanding equate to £1.5m.
- Does not account for possible sale of Tote.
- Assumes 100% of foreign racing gross profit is attributable to LBO.
- Assumes WH telephones business moves offshore Nov 10 – it did not.

**BOOKMAKERS COMMITTEE 50<sup>TH</sup> LEVY SCHEME FORECAST, MODELLING AND ASSUMPTIONS**

The 2 scenarios modelled by HBLB are as follows:

Scenario A forecasts a **'low yield'** decline from 48<sup>th</sup> – 50<sup>th</sup> Levy Scheme. The theoretical yield for the 49<sup>th</sup> Levy Scheme is £72m.

	LBO	Telephone	Internet	Exchanges	Other
48 <sup>th</sup> to 49 <sup>th</sup> Scheme	-3.0%	18.3% <sup>1</sup>	-53.8% <sup>3</sup>	0%	-8.0%
49 <sup>th</sup> to 50 <sup>th</sup> Scheme	-2.5%	-30.9% <sup>2</sup>	-3.0% <sup>4</sup>	0%	-6.0%

<sup>1</sup> This assumed decline comprises 3 elements a) WH telephone move off-shore 1 Jan 11 b) a 10% reduction in profits of telephone betting for firms remaining on-shore c) a positive correction to account for anomalous activity.

<sup>2</sup> This assumed decline comprises 2 elements a) direct effect of WH located off-shore b) a 10% reduction in profits of telephone betting for firms remaining on-shore.

<sup>3</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) a 3% reduction in profits of internet betting for firms remaining on-shore.

<sup>4</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) an 3% reduction in profits of internet betting for firms remaining on-shore.

Scenario B forecasts a **'high yield'** decline from 48<sup>th</sup> – 50<sup>th</sup> Levy Scheme. The theoretical yield for the 49<sup>th</sup> Levy Scheme is £73m.

	LBO	Telephone	Internet	Exchanges	Other
48 <sup>th</sup> to 49 <sup>th</sup> Scheme	-2.0%	24.9% <sup>5</sup>	-52.4% <sup>7</sup>	0%	-6.0%
49 <sup>th</sup> to 50 <sup>th</sup> Scheme	-1.0%	-27.1% <sup>6</sup>	-0% <sup>8</sup>	0%	-5.0%

<sup>5</sup> This assumed decline comprises 3 elements a) WH telephone moved off-shore 1 Jan 11 b) a 5% reduction in profits of telephone betting for firms remaining on-shore c) a positive correction to account for anomalous activity.

<sup>6</sup> This assumed decline comprises 2 elements a) direct effect of WH located off-shore b) a 5% reduction in profits of telephone betting for firms remaining on-shore.

<sup>7</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) a 0% reduction in profits of internet betting for firms remaining on-shore.

<sup>8</sup> This assumed decline comprises 2 elements a) assumed direct effect of move off-shore by 3 companies b) an 0% reduction in profits of internet betting for firms remaining on-shore.

**Methodological Assumptions**

The Committee uses the same methodological modelling assumptions used by the Board's Executive in **Annex B** to allow for direct comparison between forecast yields.



**RECOMMENDATIONS FOR THE 50<sup>TH</sup> LEVY SCHEME**

- 7.1 The Committee recommends that the levy should continue to be based on a percentage payment of bookmakers' gross profits on horseracing business conducted in Great Britain. For the purposes of the 50<sup>th</sup> Levy Scheme, this term shall mean the gross profit derived from horserace betting business conducted on horseracing taking place in England, Scotland and Wales only.
- 7.2 Rates: LBO/Telephone/Internet Bookmakers. Bookmakers making gross profit via betting on British horseracing on these channels should continue to pay 10% of gross profit as levy.
- 7.2.1 LBO Threshold. As in previous years, an increase in the threshold figure at which the headline rate of levy is payable by the LBO sector is recommended. The recommendation is that reduced charges should apply for all shops showing a relevant gross profit of less than £123,000. Shops with a gross profit of less than £123,000 will pay a rebated charge on a sliding scale related to the percentage by which their gross profit falls short of £123,000.
- 7.3 Rates: Bookmakers Engaged in Spread Betting. We recommend that bookmakers who derive their gross profit from spread betting businesses should pay levy at 2% of such gross profit, where it arises from British horseracing.
- 7.4 Rates: Betting Exchanges. We recommend that betting exchanges should continue to be assessed for levy on the basis of 10% of their gross profit on British horseracing business, where gross profit is defined as the commission deducted by the exchange from the amounts paid out by it to bettors and bet-takers.
- 7.5 Racecourse Bookmakers. We recommend that the previous annual fixed fee for racecourse bookmakers who stand at licensed racecourses should be retained, with the proposal that the fee should be set at £210<sup>37</sup> per annum.
- 7.6 Point-to-Point Only Bookmakers. In respect of bookmakers who stand only at point-to point events and/or at harness-racing and/or trotting events, the Committee would propose that their annual fixed contribution should be increased in line with RPI to £166<sup>38</sup>. Bookmakers who otherwise pay levy under other clauses would be exempt from any additional payment under this sub-paragraph.
- 7.7 Default Percentage. The Committee recommends that bookmakers who are unable to measure their British horseracing gross profit be required to base their declarations for levy on the average percentage of gross profit attributable to British horseracing achieved by Ladbrokes plc, Gala-Coral Group, William Hill plc and Corbetts in their combined LBO estates during the calendar year 1<sup>st</sup> January – 31<sup>st</sup> December 2011. We will seek to expand the number of independents in the sample.

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<sup>37</sup> Based on assumed RPI of 5% [actual 4.8%] on 31 Jul 10.

<sup>38</sup> Based on assumed RPI of 5% [actual 4.8%] on 31 Jul 10.