Right Honourable Jeremy Hunt MP
Secretary of State for Culture, Olympics, Media & Sport
Department for Culture, Media & Sport
2 – 4 Cockspur Street
London
SW1Y 5DH

30th November 2010

Dear Secretary of State

50TH LEVY SCHEME – 2011/12

1. The Government Appointed Members of the Horserace Betting Levy Board (HBLB) are pleased to be given the opportunity to provide you with an independent recommendation on the terms of the 50th Levy Scheme.

HBLB

2. HBLB is the UK statutory body that was originally established by the Betting Levy Act 1961 ("1961 Act") and operates in accordance with the provisions of the Betting, Gaming and Lotteries Act 1963 ("1963 Act"), as amended including by the Horserace Betting Levy Act 1969 ("1969 Act").

3. The HBLB is charged with the duty of assessing and collecting monetary contributions in accordance with the formal annual Levy Scheme from Bookmakers and the Horserace Totalisator Board ("the Tote") and applying them for purposes conducive to any one or more of the following: improvement of breeds of horse, the advancement or encouragement of veterinary science or veterinary education and the improvement of horseracing.

4. HBLB consists of:

Paul Lee	Chairman, Government Appointed Member
Penny Boys	Deputy Chairman, Government Appointed Member
Paul Darling	Government Appointed Member
Will Roseff	Chairman Bookmakers' Committee

Paul Roy	Chairman British Horseracing Authority (BHA)
Paul Dixon	Chairman Horsemen's Group
Ian Barlow	Chairman Racecourse Association (RCA)
Mike Smith	Chairman the Tote
Thomas Murphy	Observer, Deputy Chairman Bookmakers' Committee

BACKGROUND TO DETERMINATION

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

6. For the 50th Levy Scheme, the process to be followed was altered whereby HBLB invited Racing to present its proposals to HBLB and invited the Bookmakers' Committee to respond to Racing's proposals when forwarding its Recommendations.

7. Racing, represented by the BHA, Horsemen's Group and RCA, made its submission for the 50th Levy Scheme in March 2010. Racing assessed its reasonable needs at £130m to £150m. Racing's Executive Summary is at Annex A. Additionally, in September 2010 Racing submitted a proposal that the 50th Levy Scheme should be based on turnover rather than gross profits.

8. The Bookmakers' Committee submitted its Recommendations for the 50th Levy Scheme in line with its statutory responsibility in July 2010. The major change from the 49th Levy Scheme is a proposed increase in the threshold figure to £123,000. Based on these Recommendations it is estimated by HBLB that the yield for the 50th Levy Scheme is in the range of £50m to £57m. The Bookmakers' Committee's Executive Summary and the Recommendations are at Annex B.

9. Subsequently, each side responded to the other's submissions.

10. The Bookmakers' Committee's Recommendations were rejected on 15th September 2010 by HBLB and no further Recommendations were made, although the Government Appointed Members tried hard to facilitate further negotiations up to 31st October 2010.

11. The Government Appointed Members commissioned Deloitte to provide them with assistance in the assessment of all submissions from Racing and the Bookmakers' Committee provided to HBLB. Deloitte's Executive Summary produced in October 2010 is at Annex C. This Annex examines both submissions.

METHODOLOGY OF ARRIVING AT GOVERNMENT APPOINTED MEMBERS' RECOMMENDATIONS

12. The Government Appointed Members have taken into account all submissions, HBLB Members' statements and comments, many discussions with the wider horseracing and betting industries, financial modelling, comments made by Deloitte in the recent independent report and

what is actually permissible in terms of current legislation. As such, as an independent group, we believe that we are well placed to make recommendations.

13. We have been influenced by the following principles in arriving at our recommendations for a target yield:

- There must be fairness between Betting and Racing.
- Britain should remain an attractive place to do business for both of them.
- The Levy is a mechanism, but it is necessary to consider the target yield in the first instance.
- There is no scientific basis for determining a target yield; rather independent judgement is critical and fundamental.
- 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.
- Whilst taking Deloitte's report into consideration, the submissions have been independently considered and we have exercised our own discretion.

14. We have also been influenced by the following factors in arriving at our recommendations:

- HBLB's consultation exercise concerning whether or not certain users of betting exchanges should be regarded as leviable bookmakers under the 1963 Act. Were any change to be made, which is still under consideration, the revenue which might flow is not included in our proposals for the 50th Levy Scheme.
- HBLB's discussions concerning offshore betting operators making a proper contribution to the funding of horseracing in Britain. Were any change to be made, the revenue which might flow is not included in our proposals for the 50th Levy Scheme.
- If such changes were made and income flows generated to the Levy, then the headline rate should be reconsidered.
- The financial benefits which racecourses enjoy from the sale of their picture rights is set to improve substantially in 2012 as new contracts come into force.
- It will take at least one year for the structural changes that we understand Racing is examining to take effect, especially in the areas of Regulation & Integrity.

GOVERNMENT APPOINTED MEMBERS' RECOMMENDATIONS

50th Levy Scheme Target Yield

15. The target yield for the 50th Levy Scheme is in the region of £75m to £80m.

50th Levy Scheme Headlines

16. The following recommendations are made:

- Thresholds should be abolished.

- Levy should be reintroduced on foreign racing at the same headline rate as the domestic rate.

- The headline rate should reduce to 9% of gross profit.

50TH Levy Scheme Terms

17. The terms should be as follows:

a. The Levy should be based on a percentage payment of bookmakers' gross profits on all horserace business. For the purposes of the 50th Levy Scheme, this term shall mean the gross profit derived from horserace betting business on all domestic and foreign horseracing, whether such business is carried on personally or through servants or agents and whether carried on by post, telephone or any other matter whatsoever.

b. Rates: Licensed Betting Offices (LBO)/Telephone/Internet Bookmakers. Bookmakers making gross profit via betting on horseracing on these channels should pay 9% of gross profit as Levy. In contrast to recent years, no abatement of this rate is proposed for LBOs.

c. 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 horseracing.

d. Rates: Betting Exchanges. We recommend that betting exchanges should continue to be assessed for Levy on the basis of 9% of their gross profit on horserace 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.

e. 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[1] per annum.

f. 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 annual fixed contribution should be

[1] Based on RPI percentage change over 12 months ended 31 July 2010 of 4.8% .

increased in line with RPI to £166[2]. Bookmakers who otherwise pay Levy under other clauses would be exempt from any additional payment under this sub-paragraph.

g. Default Percentage. Bookmakers who are unable to measure their horseracing gross profit be required to base their declarations for Levy on the average percentage of gross profit attributable to horseracing achieved by Ladbrokes plc, Gala-Coral Group, William Hill plc and Corbetts in their combined LBO estates during the calendar year 1st January – 31st December 2011. The Bookmakers' Committee will seek to expand the number of independent bookmakers in the sample.

EXPLANATIONS FOR RECOMMENDATIONS

Recent History of the Levy

18. In order to set the scene for our recommendations, the Government Appointed Members focussed on the need to understand the recent history of the Levy.

19. Table 1 shows the allocation of heads of expenditure (excluding exceptional items, disposals of fixed assets and tax) over the last five Levy Schemes, the forecast for the current 49th Levy Scheme (2010/11) and the current budget for calendar year 2011. The actual Levy yields and utilisation of reserves (including gains arising from disposal of subsidiary) to balance expenditure with total income received by HBLB are also shown.

[2] Based on RPI percentage change over 12 months ended 31 July 2010 of 4.8% .

Table 1

	Year ended 31 March (1)						Calendar year (1)
	Actual 2006 £'000	Actual 2007 £'000	Actual 2008 £'000	Actual 2009 £'000	Actual 2010 £'000	Forecast 2011 £'000	Budget 2011 £'000
Levy Scheme	**44th**	**45th**	**46th**	**47th**	**48th**	**49th**	
						a	**b**
Prize money	64,019	65,394	56,647	59,418	64,000	49,853	33,900
Racecourses	7,879	7,216	6,652	6,958	6,638	3,804	2,100
Regulation & Integrity	18,214	24,013	35,529	24,978	25,912	21,721	16,400
Breeders' Prizes	1,773	1,510	1,673	1,745	1,773	1,150	700
Veterinary	3,178	2,214	2,364	2,633	2,055	1,361	920
Training	2,113	1,152	2,214	973	1,225	885	900
Point-to-Point	318	327	309	312	396	246	200
Ch 4 racing	267	734	879	458	225	1,000	1,000
Breed Societies	160	172	172	172	283	100	100
HBLB & BMC costs	3,817	3,572	3,884	3,878	3,414	3,546	2,900
Other (including pension costs)	10,328	(150)	1,527	365	519	1,381	900
Total expenditure (excluding exceptional items, disposals of fixed assets and tax)	**112,066**	**106,154**	**111,850**	**101,890**	**106,440**	**85,047**	**60,020**
Actual Levy Yield	**99,338**	**99,300**	**115,385**	**91,646**	**75,385**	**64,900**	**59,450**
Utilisation of Reserves (including gains arising from disposal of subsidiary)	**(7,659)**	**3,830**	**6,856**	**(7,750)**	**(31,099)**	**(20,147)**	**(470)**

(1) The Levy year is April to March whereas the racing industry operates on a calendar year. In order to help Racing's planning, HBLB currently issues its budgets on a calendar year basis; hence the last column. Therefore the first three months of calendar year 2011 are included in both column (a) and column (b).

20. HBLB expects the 49th Levy Scheme (2010/11) to yield in the region of £65m, and we estimate that the 50th Levy Scheme yield (2011/12), based on an illustrative Scheme of 10% gross profits with normal RPI increases to thresholds (i.e. a "rollover"), will be in the range £58m to £65m. HBLB has set the 2011 calendar year expenditure budget at £60m, for reasons of prudent financial planning.

21. As can be seen in Table 1, in recent years HBLB has utilised reserves (including gains arising from disposal of subsidiary) to make up the shortfall between budgeted and actual income.

Forecasting

22. HBLB sets its annual budgets having regard to the best available information provided by the Bookmakers' Committee. The Bookmakers' Committee used to provide formally to HBLB quarterly information about Levy yield but, following the arguments over TurfTV in 2006/07, the Committee ceased to do this. The Bookmakers' Committee has now agreed to provide again quarterly information.

22. Either by Determination or by agreement, the Levy rate has been consistently set at 10% of gross profits with RPI added to thresholds since 2002 when the Secretary of State determined the 41st Levy Scheme. HBLB unanimously agreed to a rollover of 10% of gross profits in 2008 for the 48th Levy Scheme (2009/10) and in 2009 for the 49th Levy Scheme (2010/11).

23. Budgets were set by HBLB on the basis of indications from the Bookmakers' Committee of the likely yield that would arise in any Levy year. To demonstrate the harmful effect on HBLB's reserves, cash flow and distribution as a result of the significant difficulties in forecasting income:

- At the meeting in July 2008, HBLB approved the assumption upon which to base the outturn of the 47th, 48th, 49th and 50th Levy Schemes' yields at £99.2m. This was agreed by the Bookmakers' Committee's representatives. Using that assumption, HBLB approved in October 2008 a "rollover" for the 48th Levy Scheme. The actual Levy yield was £75.4m – a difference of £23.8m

- In December 2008 HBLB approved revised assumptions, agreed by the Bookmakers' Committee's representatives of:

47th	£97.6m
48th	£96.2m
49th	£94.9m

- In February 2009, the Chairman of the Bookmakers' Committee offered HBLB a "rollover" for the 49th Levy Scheme. Using an assumption of £94.9m, HBLB approved in April 2009 a "rollover" for the 49th Levy Scheme. The actual Levy yield is likely to be £65m – a difference of £29.9m

- Forward estimates were regularly approved by HBLB, agreed by the Bookmakers' Committee's representatives, to try to ensure that budgets were on track, but these continued to be far too optimistic, including in February 2010 when the Chairman of the Bookmakers' Committee stated that he thought that the final Levy figure would be slightly higher than the predicted figure (of £85m) and at the close of the 48th Levy Scheme seven weeks later it was actually £75.4m.

24. Reasons put forward by HBLB Members for the falls in Levy yield include the recession, the introduction of TurfTV causing operational difficulties in LBOs, the introduction of 48 hour declarations by Racing increasing the number of non-runners, fewer horses in races, lower margins, increased use of betting exchanges instead of traditional bookmakers, an increase in number of offshore platforms and a general trend away from betting on horseracing.

25. The move offshore initially of certain internet betting operators and subsequently of some telephone betting operators has had a particularly significant effect on Levy yield over the last two years and the full year impact for the 50th Levy Scheme is estimated to be about £7m.

26. It is also recognised by HBLB that 2007/08 was an exceptional year with an additional £16m coming from "high rollers". The Government Appointed Members consider that this was a "one-off" event and is unlikely to be repeated.

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

27. In many respects, horseracing in Britain remains successful as determined by a range of indicators – quality of horses, quality of races and attendance at racecourses. However, to some degree, the health of horseracing in Britain has been maintained because of a lag effect where higher levels of Levy distribution have been financed from utilisation of HBLB reserves.

28. As referred to in Paragraph 20, the current structure and scope of the Levy is estimated to provide a Levy yield in the 50th Levy Scheme in the range of £58m to £65m. This assumes the same fixture list and approximate race programme in 2011 as in 2010, which is by no means certain, as we do not yet know the precise short-term, or even the longer term, effects of our current expenditure budget of £60m for 2011.

29. It is difficult to quantify or gauge accurately possible future effects, especially across such wide-ranging and broadly-based industries. However, we believe that, over the next few years, to put the structure of horseracing and thoroughbred breeding in Britain at further risk by a yield in the 50th Levy Scheme in the range of £58m to £65m could lead to significant economic loss, particularly in rural communities, and could damage an internationally important and successful industry within Britain. It could also damage bookmakers' businesses if there were considerable reductions to the current fixture list and the number of horses in races.

30. Furthermore, even the real effects of a yield below our target yield of £75m to £80m would probably not be known until 2012 and beyond, because we believe that racecourses and horsemen would opt for short-term emergency procedures, unable to be sustained for long, in expectation or hope of improvements.

31. To explain and illustrate the possible effects, we have taken the known financial consequences of the 2011 expenditure budget of £60m and examined various significant areas, in the knowledge that some effects may come about and some may not. It is important to bear in mind that this expenditure budget is based on the estimate of the 50th Levy Scheme yielding in the range of £58m to £65m, rather than our target yield of £75m to £80m. But we believe that these effects will still apply unless target yield is met.

- Prize money grants paid by HBLB, the lubricant of the racing industry, will reduce from £65m in 2009 through £55m in 2010 to £34m in 2011. Although difficult to quantify:

    - Some owners, including leading international owners on the Flat, might transfer their horses to other countries, especially France, to be trained and to race. One or two of the leading owners moving away would have serious ramifications.
    - Some other owners, especially at the lower end, might no longer continue to own racehorses.
    - Some breeders might choose to go out of business or produce fewer foals. Fewer foals would mean that the horse population would decrease, but not immediately, rather in two to three years as horses reach maturity, and longer for jumpers.
    - Less owners, less breeders and less racehorses might mean less business, lower profitability leading perhaps to insolvency, economic failure and job losses amongst trainers, jockeys and stable staff and dependent businesses such as vets, farriers, transporters and others peripheral enterprises.

- The Fixture Incentive Scheme paid to racecourses by HBLB will reduce from £6.9m in 2009 through £6.6m in 2010 to £2.1m in 2011. This scheme incentivises racecourses to hold fixtures on days when gate receipts are low so that bookmakers and the Levy have an important continuous horseracing betting product. This applies mainly to Monday to Thursday afternoons, especially in mid winter. Although difficult to quantify:

    - Some racecourses might abandon these important bookmaker and Levy-friendly fixtures and move to fixtures when gate receipts would be higher, for example on Saturday afternoons, thereby denuding part of the week and swamping another part of the week. Bookmakers may be able to compensate to some degree by offering other products, but the Levy would reduce further.
    - Specifically, a move away from, or reduction in, horseracing on weekdays at smaller racecourses might have a weakening effect on the winter jumping programme, as there would be fewer opportunities to prepare for the Festival meetings.

- The combination of lower prize money levels at £34m and lower incentivisation at £2.1m in 2011 might, in time:

    - Influence one or more smaller racecourses to close, change programmes or diversify away from horseracing, with independent jumping racecourses being vulnerable. Racecourses such as Catterick, Hereford, Folkestone, Hexham, Fakenham, Newton Abbot, Plumpton, Sedgefield, Towcester and Worcester are already due to receive between 43% and 68% less in HBLB grants for prize money in 2011.
    - Influence all racecourses to change fundamentally the type of horseracing by concentrating on lower quality fixtures which require less prize money. Racecourses such as Bath, Beverley, Brighton, Hamilton Park, Musselburgh, Nottingham, Pontefract, Ripon, Salisbury, Thirsk and Wolverhampton are already due to receive between 37% and 51% less in HBLB grants for prize money in 2011. The Jockey Club Racecourses and the large independents such as York, Goodwood and Newbury might also have little option but to reduce their prize money and hence quality of racing. At the top end, Ascot will probably have to reduce its annual prize money by about £1m, thereby undermining its leading international status as one of the leading Flat racecourses in the world.

- Regulation & Integrity grants paid by HBLB will reduce from £25.0m in 2009 through £25.9m in 2010 to £16.4m in 2011. Part of this reduction will have to be funded by racecourses and horsemen, thereby exerting even more financial pressure on them.

- Veterinary grants paid by HBLB will reduce from £2.5m in 2009, through £1.9m in 2010 to £0.9m in 2011. Only existing commitments are being funded: these are three education awards that started in October 2010, year 3 of a 4 year programme for infectious disease services and the final year of the 3 year equine influenza programme. Of the 8 new research programmes recommended by the Veterinary Advisory Committee, funding is only available for 2. Post 2011, the stability of specialist equine research expertise, the infrastructure to respond effectively to a disease outbreak and the long term infectious disease surveillance and prevention programmes might not be funded.

- HBLB grants to breeds of horses (Breeders' Prizes and Breed Societies) will reduce from £2.1m in 2009, through £ 1.4m in 2010 to £0.8m in 2011, probably further harming the thoroughbred breeding industry and possibly threatening the viability of some breed societies.

- A reduction in the current annual fixture list of maybe 400 fixtures in 2012 or beyond might happen because they would not be financially viable for racecourses to put on and/or because they would not be sufficiently generative to the Levy for HBLB to fund them. This could reduce Levy yield by up to £16m.

32. In effect, HBLB would be severely impaired in carrying out its statutory role for the improvement of breeds of horses, the advancement or encouragement of veterinary science or

education and the improvement of horseracing, because there would be insufficient funding from the Levy.

Target Yield

33. The Government Appointed Members judgement is that the target yield for the 50th Levy Scheme is in the region of £75m to £80m. Table 2 shows the illustrative make-up of a Levy yield of £77m:

Table 2

	£'000
Prize money	48,000
Racecourses	3,500
Regulation & Integrity	16,500
Breeders' Prizes	1,500
Veterinary	2,000
Training	1,000
Point-to-Point	300
Breed Societies	200
HBLB & BMC costs	3,000
Other (including pension costs)	1,000
Total	**77,000**

34. A Levy yield of £75m to £80m would mean that, for 2011/12:

- Prize money at £48m and the Racecourses' Fixture Incentive Scheme at £3.5m should be sufficient to underpin the race programme, racecourses' viability, ownership of racehorses and the breeding industry, based not least on previous discussions within Racing.
- Horsemen and racecourses would continue to have to fund the major part of the reduction by £7m of Regulation & Integrity.
- HBLB's other statutory commitments to veterinary and breeds of horses would still be below 2009 levels, but acceptable.

DISCUSSION ON TERMS OF THE 50TH LEVY SCHEME

Bookmakers' ability to pay and Racing's needs

35. These terms usually come to the fore when trying to work out an appropriate Scheme. As Deloitte's report implies, they are not straightforward to interpret. Whilst the terms were removed from the 1963 Act by the 1969 Act, a Parliamentary assurance was given to consider them still, but there does not appear to be a mandatory requirement in a Determination by the Secretary of State.

36. There is no widely accepted or documented definition of these terms. Betting's and Racing's views are very different and unlikely to be reconciled. The Government Appointed Members have concluded that both terms have no commonly-agreed meaning., We prefer to 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 content of the Scheme when determining a Levy Scheme. A Determination assumes discretion to be exercised, given the circumstances of the time.

37. We tend to agree with Deloitte that the bookmakers have not demonstrated incapacity to pay. By this we mean that the bookmakers have not properly demonstrated that they could not pay more than has been offered as the basis for the 50th Levy Scheme. We do not believe, for the purposes of the 50th Levy Scheme, that other factors such as Gambling Commission fees, rent etc. should be taken into account.

38. Of all the issues in making our recommendations we find the definition and interpretation of Racing's needs one of the most difficult and puzzling. We tend to agree with Deloitte that Racing has not justified its case for a Levy yield in the range sought by it.

Payments from Betting to Racing

39. The value and nature of payments, especially media rights[3], made by Betting for Racing is a particularly contentious issue. Using information obtained from the Bookmakers' Committee and various other sources, we have estimated the net outgoings from Betting related to the Levy media rights. These figures are based on a number of assumptions, but are considered to represent a reasonable approximation of the recent history of payments made by Betting. They do not include sponsorship, the Tote's additional contribution to Racing and the sale of picture rights abroad. Table 3 breaks down our assessment of payments made by Betting.

[3] By media rights, in this context, we mean the sale of live British horseracing picture rights and associated services by racecourses to SIS and TurfTV and subsequently by SIS and TurfTV to LBOs

Table 3

NB. All data £m		2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11 (forecast)
	1 - Levy	110.7	105.6	99.3	99.2	115.3	91.6	75.4	65.0
	2 - Betting shop media rights payments (minus dividends paid to bookmaker shareholders) to SIS and TurfTV	60.1	60.8	52.3	67.0	75.0	91.0	104.0	104.0
	3 - Total payments made by Betting (1 + 2)	170.8	166.4	151.6	166.2	190.3	182.6	179.4	169.0

40. Table 4 shows our assessment of the fees paid to racecourses from the sale of live British horseracing picture rights into LBOs, including operating cost benefits and dividends paid to racecourses by TurfTV. (To ensure consistency and aid understanding these figures are shown on a fiscal year basis, though they have been derived from calendar year information and pro-rated accordingly. They therefore represent an aggregated approximate total.)

Table 4

	2006/07	2007/08	2008/09	2009/10	2010/11 forecast	2011/12 forecast	2012/13 forecast
£m	33.5	40.5	50.3	57.0	57.0	61.3	77.0

41. The key comparisons are the amounts that bookmakers pay (row 2 in Table 3) and the amounts actually received by racecourses (Table 4). Dividends to bookmaker shareholders in SIS have not been included in row 2 of Table 3 whereas dividends to racecourse shareholders in TurfTV have been included in Table 4, because the latter is income to racecourses. As well as showing the increasing revenues for racecourses, the table demonstrates that media rights do not appear to be a particularly efficient basis of a transfer value from Betting to Racing, unlike the Levy.

42. There is no legal obligation on the owners of TurfTV, or indeed SIS, as far as is known, to contribute to Racing's central costs, and no formal machinery in place at present which requires a racecourse which increases its commercial income to contribute to those costs.

43. The revenues received by racecourses for the sale of picture rights at Table 4 have not changed significantly since 2008/09, but will do so in 2012 on current forecasts. The Government Appointed Members believe that this should more appropriately be taken into account when assessing Racing's needs in 2012 (i.e. the 51st Levy Scheme).

Thresholds

44. Previous Levy Schemes have provided that, if an LBO's profits made from British horseracing exceed a certain figure (the 'threshold level'), Levy liability is 10% of those profits. However, if horseracing profits fall below that threshold level, the percentage of those profits payable is calculated based on the ratio of the profits related to the threshold level. The threshold level is currently applied to the profits of each LBO rather to the entirety of a bookmaker's LBO business.

45. The threshold from the 49th Levy Scheme is £88,740. In previous Schemes, the threshold has been adjusted by RPI for the 12 months ended 31 July which, if applicable to the 50th Levy Scheme, would mean that the threshold would be £93,000. The Bookmakers' Committee's Recommendations for the 50th Levy Scheme, rejected by HBLB on 15th September 2010, included an above-inflation rise in the LBO threshold to £123,000 in order to take account of increasing charges to bookmakers for the sale of pictures into LBOs, which would mean that about 90% of LBOs would pay an abated Levy percentage rate below 10%. There is then the 'double-whammy' effect of thresholds, in that, if an LBO falls below the threshold, not only does it pay less Levy by virtue of its profits having fallen, but then it pays even less because of the impact of the abated rate. The effect of the Bookmakers' Committee's Recommendations of thresholds at £123,000 is estimated to reduce Levy by some £14m, rather than about £8m originally estimated by the Bookmakers' Committee.

46. Thresholds and their predecessor were established at a time when bets on British horseracing constituted a far greater proportion of the bookmakers' business. The general trend over the last 8 years has been for horseracing to be a declining portion of the bookmakers' business. As a percentage of gross win on all betting products, excluding gaming machines, betting on British horseracing has fallen from 63% in 2002/03 to 43% in 2009/10. When including gaming machines, the decline is even sharper, falling from 42% in 2002/03 to 23% in 2009/10.

47. Deloitte considered this issue and proposed that one possible approach for setting thresholds is to adjust the threshold figure downwards to reflect the fact that British horseracing represented a declining proportion of the bookmakers' business but, at the same time, provide some allowance for the increased media costs. Their calculation produced a revised threshold figure of £49,000, which would then be increased to reflect the SIS and TurfTV costs in respect of British horseracing, per LBO, which they estimate to be £15,400. The report concludes that, on this basis, the estimated threshold would be £64,400.

48. Thresholds provide relief on an LBO-by-LBO basis and thus the benefit that arises from thresholds accrues to big and small operators alike. There is therefore an argument that thresholds should be abolished entirely for all bookmakers with more than a certain number of shops. In the current economic climate, and in order to provide some relief to smaller bookmakers, the Government Appointed Members have considered various threshold schemes which might be applied to provide relief for the smallest betting shop operators. Our deliberations included the advantages of applying threshold levels to combined LBOs of each bookmaking company (a company rather than shop-based Scheme).

49. In particular, we examined the merits of only applying thresholds to bookmakers with 5 shops or less which would mean that over 90% of betting shop operators, albeit small ones, would continue to benefit from thresholds. This option would mean abolishing thresholds for bookmakers which own more than 5 shops (including shops owned or controlled by that bookmaker or owned or controlled by connected entities or under common control) and increasing thresholds by RPI to £93,000 for bookmakers which own 5 shops or less (including shops owned or controlled by that bookmaker or owned or controlled by connected entities or under common control).

50. HBLB carried out a review into thresholds during 2010 under the Deputy Chairman (Threshold Review Group). Whilst this Group, working on the 47th Levy Scheme and data then available, concluded that the theoretical maximum increase in Levy yield if thresholds were abolished was in excess of £7m per annum, HBLB's current model for the 50th Levy Scheme indicates a figure between £13m and £14m, principally because thresholds and the number of LBOs below the threshold have increased since the 47th Scheme, whilst total British horseracing gross profit has fallen and, consequently, the marginal rate paid by LBOs has decreased.

51. Thresholds were introduced at a time when betting on horseracing constituted the majority of the bookmakers' business. This is no longer the case, with the gross win from British horseracing now comprising less than a quarter of the total generated from all other betting products in LBOs. The Bookmakers' Committee have argued that the removal of thresholds would increase the financial cost to bookmakers and consequently result in the closure of many smaller LBOs. However with only 23% of total LBO gross win generated from British horseracing (and about 27% if foreign racing were included), the Government Appointed Members have concluded that it can no longer be argued with justification that the continued provision of thresholds will, of itself, prevent the closure of LBOs or is indeed the pivotal factor which would determine whether an LBO remained open or not.

52. The application of a threshold level and the resulting abated rates of levy for most bookmakers is in contrast to betting tax, which has no such mechanism for providing relief to smaller bookmakers and is a flat charge regardless of the level of profitability.

53. The Government Appointed Members are confident that it would be lawful in a Determination of the 50th Levy Scheme to include changes to the thresholds, whether applying them to combined LBOs of each bookmaking company (a company rather than shop-based Scheme) or abolishing them and/or increasing or reducing the threshold level.

54. The Government Appointed Members have concluded that any attempt to implement thresholds for the smallest operators by applying thresholds to bookmakers with less than a certain number of shops will inevitably involve arbitrarily selecting a 'cut-off' figure for the number of betting shops to which it should be applied. The Government Appointed Members do not consider this to be a rational approach and we are of the view that a Levy assessment based on gross profits, with no threshold level, results in a Levy cost that already takes into account the bookmakers' capacity to pay.

55. In our final analysis, we believe that thresholds are simply no longer appropriate, fair or reasonable. As a matter of principle, they should be abolished.

Foreign Racing and Other Products

56. The Government Appointed Members are advised that there is no distinction in the 1963 Act between whether horseracing is taking place in Britain or overseas for the purposes of the Levy. There is a cogent argument that the Levy should apply what the law says. Although non-British horseracing has historically been thought to be a smaller proportion of the amount bet on horseracing in Britain than today, the total amount of Levy associated with foreign racing is irrelevant – it is the principle that matters.

57. Up to and including the 41st Levy Scheme, the wording of a Scheme required a bookmaker to pay Levy on all horserace betting business. The 42nd Levy Scheme saw agreement on a new definition, British Horserace Betting Business, thus excluding foreign racing, defined as "the business of effecting betting transactions on horse races where such races take place in England, Wales and Scotland, whether such business is carried out personally or through servants or agents and whether carried on by post, telephone or in any other manner whatsoever". The 42nd Levy Scheme also saw the halving of the threshold level from £150,000 (41st Levy Scheme) to £75,000.

58. It appears to the Government Appointed Members that the 42nd Levy Scheme was designed so as to reflect in its principal terms the commercial data agreements between bookmakers and the British Horseracing Board which it was intended at the time would replace the Levy. However, after a European Court of Justice ruling in 2004 and a UK Court of Appeal ruling which resulted in 2005, those data agreements were no longer capable of providing a sustainable replacement for the Levy. It follows that the circumstances which led to the replacement of some 40 years of custom and practice of foreign racing being subject to Levy are now no longer in place. The proposed replacement data arrangements do not now exist and the circumstances which applied in 2002 are different today.

59. There is a question as to whether there was a linkage between the removal of foreign racing and the halving of thresholds in 2002. Racing and the Bookmakers' Committee appear to agree that there was indeed a link, but have differing views on how this link should be regarded. However the point is this: the 1963 Act does entitle HBLB to impose Levy on bets placed on foreign racing provided that the Levy has been arrived at in a way that is reasonable and fair. A conscientiously and fairly considered, properly informed decision to levy foreign racing would be reasonable and fair. It is, the Government Appointed Members believe, a weak argument that it would be irrational to levy foreign racing simply because of commercial arrangements between bookmakers and the British Horseracing Board in 2002, which subsequent Levy Schemes mirrored. That principle of fairness is one of those which has guided the recommendation.

60. It is likely that the Bookmakers' Committee would argue that there was a link between the removal of foreign racing from the Levy and the decision to halve threshold levels and that, for this

reason, if foreign racing were again levied, thresholds should rise. The Bookmakers' Committee gave consideration to this point in its Response to Racing's Submission, stating in Paragraph 7.14 that "The threshold was halved under the 42nd Scheme to compensate for loss of Levy from this source and if overseas racing was again to become leviable, the balance would have to be restored".

61. However, the Government Appointed Members have looked at the question of thresholds on their merits and have concluded that thresholds are no longer appropriate, fair or reasonable. It is difficult to envisage that this view would be any different if the basis for the level of threshold in the 48th Levy Scheme had been not the £75,000 in the 42nd Levy Scheme but £150,000. Indeed it is reasonable to assume that this opinion as to why thresholds were no longer appropriate would be even more pronounced if the threshold level was around double its current level. On this basis, the Government Appointed Members believe that the way in which thresholds were treated for the 42nd Levy Scheme is, in effect, taken into account in their view that thresholds should be discontinued for the 50th Levy Scheme.

62. Even if we were not proposing the abolition of thresholds and were proposing some other arrangement or a variation to current arrangements, we do not accept the view that the "balance" would have to be restored, assuming that this is taken to mean that the base level of thresholds would be £150,000 adjusted for inflation (now about £177,000), should foreign racing be levied. It is more appropriate to consider each Levy Scheme on its merits consistently stated.

63. Not to do so with regard to foreign racing would amount in effect to an argument that HBLB's discretion (and that of the Secretary of State) to determine a Scheme each year has been fettered, in an absolute and open-ended manner, by virtue of an alleged "agreement" to which neither HBLB nor the Secretary of State were directly party. The Government Appointed Members have seen no document or submission which convincingly supports such a conclusion.

64. We also think that it is reasonable in coming to this decision to take into account the way in which bookmakers have diversified their businesses. Live televised horseracing from various overseas jurisdictions is commonplace in LBOs. There is little differentiation in the way in which British and non-British races are televised and promoted. It is arguably "horseracing" from wherever it derives, and therefore all racing should be regarded equally. Furthermore, the overseas and domestic products are arguably more homogenous now. There is significant cross-over of horses, jockeys and trainers between countries.

65. There were informal reports during the Foot and Mouth outbreak in 2001, which saw the widespread cancellation of British horseracing fixtures, that there was a significant substitution to foreign horseracing products. The Bookmakers' Committee has itself referred to a 60% substitution to other products at this time in Paragraph 3.38 of its Response to Racing's Submission (although does not specify the proportion attributable to foreign horseracing, but it is reasonable to assume that it would be a relatively high proportion). Since then, bookmakers' product offering on foreign racing has increased. There is now a full Irish programme, significant South African programme plus more French, US and Dubai racing than in the past. Many online operators have an even wider offering.

66. These factors point to there being a clear consumer demand for foreign horseracing which, given its greater availability, has increased. 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.

67. The potential advantages for both Racing and Betting in a joint promotion of all horseracing is an additional factor (although not a determining one) in reinstating Levy on foreign racing. Furthermore, although other horseracing jurisdictions have very different funding models, we understand that most, if not all, would include foreign racing in their funding base: Ireland is probably the nearest funding model and does this successfully.

68. Finally, betting on foreign racing can be used as a benefit to domestic racing, rather than the current situation when there may be a reduced Levy as betting on domestic racing diverts to foreign racing. Race meetings from, for example, Ireland could be used to fill gaps or take the place of ineffective domestic fixtures, thus maintaining Levy yield at a lesser cost, and maintaining an agreed continuous horseracing product for bookmakers.

69. However, Racing's arguments for "convoyed sales", that is to say the contention that the existence of British racing promotes significant betting activity on other products, are considerably less relevant than they were years ago, as British horseracing's market share in relation to other products has fallen substantially. Whilst the relationship between British and foreign horseracing is clear, and foreign racing is the closest substitute and complement that British horseracing has to any other product in the betting environment, the relationship between horseracing and other products is not: this includes virtual horseracing, because the bookmakers could easily change the graphics to some other form of virtual racing not involving horses. This could not be done with foreign horseracing. We do not consider the evidence of "convoyed sales" to be persuasive and accordingly we are of the opinion that income from any other products such as virtual racing, sports or gaming machines should not be brought into charge for the Levy, even if a levy on such other products were lawful under the 1963 Act, which is not at all clear.

70. In summary, the Government Appointed Members believe that foreign horseracing should be included in the leviable base, but not other products which do not relate to horseracing. It would seem fair and reasonable for foreign racing to be levied at the same headline rate as British horseracing.

Headline Rate

71. The headline rate for Levy Schemes has remained unchanged since the introduction of a gross profits Levy in 2002 at 10% of gross profits. As each Levy Scheme is unique, there is no reason why this headline rate should remain the same in the future. There is no intrinsic reason why 10% is the appropriate figure and neither, at the time it was introduced, was there was any suggestion that it should remain fixed in perpetuity.

72. Furthermore, the headline rate can be used effectively, up or down, to correspond with the assessment of the target yield. Hence the Government Appointed Members believe that, in determining the 50th Levy Scheme, assuming the abolition of thresholds and inclusion of foreign racing, the headline rate should reduce to 9%.

73. We are very much aware that, by abolishing thresholds and including foreign racing, a significant additional burden will be placed on bookmakers, which we have sought to ameliorate by reducing the headline rate. We hope that this will also encourage bookmakers to promote horseracing as against other products to the benefit of both parties.

Betting Exchanges

74. The Government Appointed Members do not believe that a differential as between the percentage of gross profits for exchanges and the percentage for traditional bookmakers should be introduced in advance of the consultation process.

Offshore Operators

75. The Government Appointed Members do not believe that it is appropriate to make any recommendations concerning offshore operators in advance of further deliberations.

Turnover vs Gross Profits

76. Racing submitted, late in the process, a proposal to change from gross profits to turnover. There has been insufficient time to carry out proper consideration of this proposal and, in any case, the Government Appointed Members are not currently wholly persuaded by the arguments.

Guarantee and Cap

77. Since 2002/03, when the Levy calculation was changed to one based on gross profits, the annual yield has been subject to variations in line with fluctuations in bookmakers' gross profit from British horseracing. In an attempt to bring more certainty to both Racing and Betting as to the amount that is received/paid under the 50th Levy Scheme, the Government Appointed Members have considered whether or not it would possible to operate a system that employed a minimum guaranteed payment from bookmakers (say £75m), which was at the same time capped at a maximum amount (say £80m). We have concluded that, aside from whether this would be lawful

under the 1963 Act, it would be virtually impossible for HBLB to implement such a scheme from an administrative perspective. There are in the region of 1,100 separate bookmakers currently in operation and, until every single annual Levy return has been received from each bookmaker, it would not be known whether the guarantee had been reached or the cap exceeded. Past experience has shown that not all bookmakers submit their annual returns in a timely manner and therefore a significant period of time (months and possibly years) would elapse before a final calculation could be made as to the amount of under/over paid Levy in relation to the Levy guarantee or cap.

78. However, the Bookmakers' Committee may wish to consider a guarantee and cap in their submission to the Secretary of State, which the Government Appointed Members may support as long as it is not included in the wording of the Levy Scheme itself for the reasons set out in Paragraph 77. Such an arrangement would require to be achieved by separate contractual arrangements.

OPTIONS FOR THE 50TH LEVY SCHEME

Consideration of Options

79. During the submission process, the Government Appointed Members examined a number of options to achieve our target yield for the 50th Levy Scheme, based on three methods:

- Keeping, changing or abolishing thresholds.
- Continuing to exclude or including foreign horseracing.
- Keeping or changing, up or down, the headline rate.

80. These options included:

A. Abolish thresholds; include foreign racing at the same headline rate as the domestic rate; set headline rate at reduced rate of 9%; estimated yield in the range of £76m to £82m.

B. Abolish thresholds for bookmakers which own more than 5 shops (including shops owned or controlled by that bookmaker or owned or controlled by connected entities or under common control); increase thresholds by RPI to £93,000 for bookmakers which own 5 shops or less (including shops owned or controlled by that bookmaker or owned or controlled by connected entities or under common control); include foreign racing at same headline rate as domestic rate; set headline rate at reduced rate of 9%; estimated yield at £75m to £80m.

C. Reduce thresholds to £64,400 (as per Deloitte's report); include foreign racing at same headline rate as domestic rate; set headline rate at reduced rate of 9.5%; estimated yield at £76m to £83m.

D. Increase thresholds by RPI to £93,000; continue to exclude foreign racing; increase headline rate to 13%; estimated yield at £75m to £84m.

81. The Government Appointed Members believe that Option A is the best option for achieving the target yield in the range of £75m to £80m for the 50th Levy Scheme.

82. Whilst the other options are feasible, we favoured Option A because it is simple, straightforward, fair, attractive in promoting the horseracing product in Britain and provides both Betting and Racing a better opportunity than the other options to work more closely together.

A BRIDGE TO THE FUTURE

83. We believe that the proposed amendment to the role of the Secretary of State in the Determination of the Levy will encourage an improved relationship between the parties.

84. In addition, HBLB has made further substantial progress this past year. Our aim is that in 2011 we will have a balanced budget for the first time in many years; we have stated that, in future, loans to racecourses will be more commercially based and attract interest; and we have decided that the Levy will no longer take total responsibility for the reimbursement to racecourses of the costs of Regulation & Integrity, as invoiced to them by the BHA. We believe that this will encourage greater transparency and cost-effectiveness between supplier and consumer, namely the BHA and the racecourses. Soon we also currently intend to examine an even more efficient and balanced system of Levy distribution.

85. The Government Appointed Members remain optimistic of a better future providing that our recommendations, or other action delivering the same result, can be implemented. We emphasise that we see these recommendations as a one-year proposal which we believe is achievable for the reasons that we have set out.

Paul Lee **Penny Boys** **Paul Darling**