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5th January 2011

Rt Hon Jeremy Hunt Esq.
Secretary of State
Department for Culture, Olympics, Media and Sport
2-4 Cockspur Street
London SW1Y 5DH

Dear Secretary of State,

British Horseracing welcomes the opportunity to comment on the recommendations ("the Recommendations") of the Government Appointed Members ("GAMs") of the Levy Board as part of the Determination of the 50th Levy Scheme. It is a well argued document much of which we agree with. There are however two areas – the recommended rate and the question of media rights – where we reach a different conclusion.

Our response should be read in the context of our prior submissions and correspondence with you, specifically our letter to you dated 9th November 2010 and our detailed submissions made as part of the new Levy process – you have the Executive Summary of our first submission as Annex A to the Recommendations.

Summary

We:

- Support the GAMs' recommendation to abolish thresholds as a matter of principle;
- Support the GAMs' recommendation to reintroduce Levy on foreign racing at the same rate as applies to British horseracing;
- Welcome their support in asking you to expedite extending the collection of Levy from offshore operators; and
- Urge that action is taken, following completion of the current consultation by the Levy Board on the status of certain users of betting exchanges, to collect Levy from all who are liable under the 1963 Act, and to independently assess and then address the overall impact of exchange betting on the Levy.

However, we do not agree with two key conclusions reached by the GAMs, namely:

- That the target yield should be as low as £75m to £80m and that it is sensible to reduce the rate of Levy from 10%, this pending the collection of Levy from offshore operators and a resolution on betting exchanges, and also recognising the intrinsic uncertainties in forecasting of Levy income; and

- That there is any linkage between statutory Levy payments and media rights payments since they have always operated in separate markets, and the most recent deals were struck against a backdrop of Levy payments of around £100m.

Introduction

Racing has devoted very significant resources to achieving an equitable funding relationship with each of the very different constituent parts of the betting industry, that is fit for the modern gambling environment. This included attempts to negotiate with the betting industry in the body of the Bookmakers' Committee under the auspices of the Levy Board, but this proved impossible from our perspective because the Bookmakers' Committee did not fully participate in the manner envisaged when the new informal process for agreeing the 50th Scheme was devised and agreed by the Levy Board.

Nevertheless we remain committed to supporting the Levy Board and the Government in modernising the Levy. This is what we have advocated for many years, and we welcome your stated intent to change the Levy system to remove the Secretary of State as the determinator if no agreement can be reached. Your Ministerial colleague and officials have our detailed proposals on this, and we look forward to focussing on this in the coming months, once you have determined the 50th Scheme.

There has been a severe decline in the Levy in recent years, from £115m in 2008 to £75m in 2010 and with a forecast of £65m this year. As a consequence, there has been a damaging drop in key headings of expenditure across the sport and industry, particularly going into 2011. This severe decline may be attributable to a variety of factors, however, we consider to be chief among them the structural deficiencies in the Levy that have seen the collection base narrowed significantly. Our Racing United campaign identified four such loopholes requiring attention, and we welcomed the subsequent Government statement repeated in many forms that you wish to "ensure the funding for racing is fair, and collected from as broad a base as possible".

Methodology

We agree with the GAMs' starting principles as laid out in the Recommendations, as these adopt the approach advocated in our submission. There must be fairness between Betting and Racing, and Britain should indeed remain an attractive place for both to be able to do business. For Betting this principally requires an appropriate and attractive regulatory framework and equality of treatment of onshore and offshore operators. For Racing, this requires action to be taken to restore the Levy yield to the levels prevailing as recently as 2008.

Racing asks for no protection against the effects of the recession, but it does believe that the Levy should be paid equitably by all those whose business derives customers and profits from British horseracing. The Levy is not a "subsidy" in the pejorative sense that Betting has portrayed it; it is the method in law by which the value provided by Racing to all betting operators is recognised. As the last thorough Government review of the issue stated, the Levy is "a mechanism for transferring funds from the business of betting on horseraces to horseracing in a broad sense". This principle remains fundamental.

British horseracing is a British sporting success story. The sport is taking all the actions it can in order to address the market opportunities and challenges it faces. Racing is innovating in terms of its product and facilities and we are seeing positive impacts from that. Where Racing has been badly let down is in the failures in the last decade to deliver a modern statutory funding framework for the key market – betting – in which we operate.

Prize money and owners' returns in this country languish at the foot of the international table. Against this backdrop, we agree with the GAMs that the "structure of horseracing and thoroughbred breeding in Britain should not be put at further risk", and that the investment from owners, which amounts to over £500m per annum, the vast majority of which is injected into and helps support the rural economy, "is the cornerstone of the industry with prize money as its key lubricant, flowing to all participants."

Addressing the Loopholes

We turn now to the GAMs' specific recommendations.

Thresholds

The argumentation in the Recommendations for the ending of thresholds for abated rates of Levy payment in Licensed Betting Offices ("LBOs") is compelling. Thresholds are indeed, as stated by the GAMs, "no longer appropriate, fair or reasonable" and should be abolished "as a matter of principle".

An extensive argument for their abolition was also put forward in our original submission. In summary, thresholds:

- Currently cost Racing around £10m per annum and rising, with 70% of LBOs now benefiting from reduced rates of Levy payment;

- Are an anomaly under a gross profits Levy; a flat rate across the board in this environment is by definition proportionate, equitable and a fair reflection of capacity to pay;

- Are an anachronism in the modern betting market, where horseracing represents 27% of betting shop gross win compared with 63% when thresholds were first introduced;

- Benefit major operators in a way never intended upon their inception, having been designed for smaller shop operators not smaller shops, and before the 'Demand Test' was abandoned; and

- Are a disincentive to the promotion of horseracing in LBOs, and are easily manipulated in order to minimise Levy payments.

Our legal advice is in line with the GAMs' view that it is lawful to abolish thresholds. Further we agree with the GAMs that any argument for their retention based on potential closures in the event of thresholds being abolished be rejected. We note that William Hill forecast 50 net shop openings in 2010. In addition, absent the 'Demand Test', there is significant proliferation of new LBOs in certain towns and streets, with clusters of shops opening in close proximity to each other, with such shops being highly likely to fall below the current threshold.

Foreign Racing

The GAMs argumentation in the Recommendations for the reinstatement of Levy on foreign racing is also compelling. It would also be lawful, based both on the relevant legislation and recent historical precedent.

This is an important element of creating a platform whereby Betting and Racing are incentivised towards joint promotional activity of horseracing betting. Reintroducing Levy on foreign racing would significantly, and properly, broaden the base of Levy collection, and would bring Britain into line with the approach internationally.

Offshore Operators and Betting Exchanges

These issues were recognised by your colleague and then spokesman on these issues, Tobias Ellwood, in April 2010 when he stated: "my colleagues and I are all too aware of the dwindling Levy sums that we have seen in recent years, due to the growth of betting exchanges and the offshore location of online operators. We understand both the factors that have contributed to this problem and what needs to be done in the long term to address their roots. A Conservative government will not allow these issues to fall by the wayside."

Although extension of the Levy to offshore operators is outside the scope of the Levy Board's current powers, we continue to consider that this leakage is significant in reducing Levy yield. The loss of Levy from the move offshore of business by just William Hill and Ladbrokes is estimated at £7m. Adding in the existing offshore operators takes the loss of Levy to more than £10m.

We ask that consideration of how best to collect Levy from offshore operators be expedited and prioritised within the Parliamentary legislative timetable.

On betting exchanges the GAMs rightly deferred judgement until completion of the current Levy Board consultation on certain users of betting exchanges, to which we have made submissions, and which we understand will be considered in detail in March 2011. This remains a significant unresolved issue for Racing. There is also the separate but related issue of the overall treatment of betting exchanges as a "different" betting platform (as has been recognised for instance within recent weeks by the Irish Government).

We are clear, as indeed are betting exchanges, that they are a different type of operator, and there is no reason why the current 10% of gross commissions is necessarily the appropriate charging basis. Spread betting operators are treated differently, for instance. We agree when betting exchanges say publicly that they are a disruptive platform, and have revolutionised the betting industry. It just does not then follow that Racing's finances through the Levy can have remained unaffected, when we are still operating on a gross profits funding model designed for a pre-internet and pre-betting exchange world.

In order to inform future discussions, an independent review should be undertaken to assess and then address the overall impact of exchange betting on the Levy.

For the purposes of the 50th Scheme we urge that for so long as the issues around offshore operators and betting exchanges remain unaddressed, there should be no consideration of a reduction in the headline rate.

Target Yield, Racing's Needs and Betting's Capacity to Pay, and the Headline Rate

We disagree with the GAMs' recommendation that the target yield for the 50th Levy Scheme is in the region of £75m to £80m, and, therefore, their associated recommendation that the headline rate should reduce to 9% of gross profit.

- Target Yield

We agree with the GAMs that "it is necessary to consider the target yield in the first instance", having advocated this approach in our detailed submission. Based on a range of factors, we believe this target yield should be far higher than £80m. The target Levy yield included in the Recommendations is considerably lower than the Levy paid historically by the betting industry prior to the severe impact, from 2008 onwards, of the four loopholes referred to above. The 49th Levy Scheme was agreed within the Levy Board in April 2009 at a level expected to yield £100m, and we have seen no basis on which the yield should be lower now than then - it is the impact of the loopholes that is driving Levy return down. You will be aware also that the last time a Secretary of State faced a similar set of issues and decided upon a target range, £90m to £105m was set by Tessa Jowell for the previous Government as long ago as 2002.

- Racing's Needs

We recognise that defining the needs of Racing is not a science, but it appears from paragraph 34 of the Recommendations that the GAMs see a Levy Board contribution towards prize money of £48m as "sufficient" to underpin the sport's current infrastructure. They state that "based not least on previous discussions within Racing" prize money from the Levy Board at £48m coupled with the Racecourses Fixture Incentive Scheme at £3.5m would be "sufficient to underpin the race programme, racecourses' viability, ownership of racehorses and the breeding industry". We believe there is a misunderstanding here since the "previous discussions" referred to were in effect crisis planning discussions within the sport pending a satisfactory modernisation of the Levy to ensure the right levels of return.

Racing faced Levy income that had dropped sharply from levels of previous years, as documented above, and at no point were discussions based on finding a sustainable level going forward. To put the £48m and £3.5m figures in context, the Levy Board funded, in 2009, prize money at £62.5m and fixture incentives at £6.5m.

On an industry-wide basis, other sources of income are either much reduced from 2009 e.g. sponsorship, corporate hospitality and non race day income, or are at best maintained in the case of attendance and media rights, where increases in the latter do not arise in the main until late 2012/2013.

In any case, any suggestion that betting operators should benefit by means of reduced payments the better Racing does in driving revenues from, say attendance, is plainly wrong and has been rejected previously.

The Recommendations are strong on the importance of prize money to the whole sport and industry. The bleak picture as portrayed in section 31 is therefore one which we recognise as a threat facing British Horseracing at current levels of Levy income, and we cannot agree it could be satisfactorily averted with a Levy yield of £75m to £80m (even if this minimum level of objective were right, which it is not, as the Levy looks to the objective of a "thriving" industry). There is a real danger of owners walking away from the sport completely, with major owners – many of whom have a number of international bases – having the option of transferring sizable strings of racehorses out of Britain. The viability of many trainers' businesses is being called into question, and significant changes to breeders' behaviour could have damaging and irreversible effects on our sport. On the racecourse side, we again concur with the threats being outlined for a whole variety of our racecourses, which all exist as significant social hubs and economic generators in their local communities.

The GAMs' target yield is also based on a £6m reduction (from £23m to £17m) in funding from the Levy for integrity services. This shortfall is being met through significant cuts in activity (with consequential risks), by racecourses which reduces the sum that is available for investment in prize money by them from other activities, and by racehorse owners, which is a further disincentive to racehorse ownership.

Returning then to the Levy Board's clear statutory objectives, we do not believe the improvement of breeds of horse, the advancement or encouragement of veterinary science of veterinary education, or the improvement of horseracing would occur under the target yield as laid out in the Recommendations.

We stand by Racing's needs as outlined in our original submission, of which you have the Executive Summary. They have been built up on robust methodology, and highlight significant increases in costs to owners and other participants in the sport as the fixture list has expanded, not least to meet demands from the betting industry. The overall burdens on owners have risen by £150m since 2002, and our key costs such has utilities, transport and other equine related headings have experienced significant inflation over the last decade. We have stated before that much of the racecourse sector exists as not for profit, and the aggregate pre tax profits of our 60 racecourses were just £19m in 2009, with cashflows far less than this owing to debt repayments and capital expenditure. We expect similar levels in 2010 and a substantial decrease for 2011 to less than £10m.

- Betting's Capacity to Pay and the Headline Rate

As importantly, though, the betting industry's overall capacity to pay has undoubtedly increased in recent years. Based on the latest results we have, the pre tax and interest operating profits of the major three betting operators plus Betfred, the Tote and Bet365 stand at c.£850m. We agree with the Recommendations that the Bookmakers' Committee has not demonstrated incapacity to pay more under the 50th Scheme. Further this would be the case whether the target yield was set at £75m to £80m or higher at £85m to £90m, so reflecting better the balance of Racing's needs and the capacity to pay of those betting operators currently within the Levy net.

In summary, for all the reasons above, we consider a reduction in the rate of levy from 10% to be inappropriate pending extension of the Levy to offshore operators and a fair settlement of Levy from the exchanges and their business users. Including both these headings would take the Levy yield much closer to what we regard as a reasonable target yield for Racing. The additional benefit of such a move would be a measure of protection against risk. Under the gross profits basis, there have been substantial shortfalls in actual Levy yield in recent years, compared with original expectations. A 9% rate could generate significantly less than £75m to £80m, even if this were considered to be the right target range.

Media Rights

We refute any linkage between Betting's statutory Levy contributions and their payments for separately identifiable rights. The only way in which such payments should be taken into account is as part of the wide assessment of the betting industry's capacity to pay, which should include all revenue sources of betting operators as well as all their costs; and in consideration of Racing's needs, but only as part of Racing's total income and expenditure from all sources.

This is a clear matter of principle: media rights paid by SIS and Turf TV are not a compensation or alternative to the Levy; they have always existed in a completely separate market. Payments for the right to provide television coverage of racecourses' fixtures in LBOs are under commercial contracts for a specific service and are paid by those bookmakers for whom the media rights adds value, to their entire business not just that related to British horseracing. Television coverage of horseracing draws customers into LBOs to play their full range of products. The value of the rights to the purchasers has increased as the range of products has grown. This is quite separate from the scope of the Levy.

Further, the price established by the purchasers of media rights was set against a background of a Levy yield of more than £100m, with no legitimate expectation that the rate of Levy would be reduced to offset any part of media rights payments. Similarly, they are completely separate from sponsorship payments, which are also for a distinct and definable service.

The Levy is based on a universal approach under which all operators can have full access to the ability to offer bets, but must all pay Levy. In contrast, numerous betting platforms – particularly phone, internet and smartphone – and even some LBOs – do not deem it necessary to have acquired and offer picture rights in order to conduct betting business, as they are not a central or necessary part of their offering. It follows that media rights payments are very different from the Levy.

It can also be argued that increased payments for picture rights are a result of the ending of a 20-year monopoly owned by betting interests in the sale and purchase of such rights, with a fair market value only now being realised. The increase in value of British horseracing pictures has been mirrored by increases in other televised horseracing, particularly from Ireland and South Africa.

On the detail as provided in the Recommendations, and all of the points above notwithstanding, we must put forward our own cross industry agreed figures for the income Racing receives in LBO media rights from the betting industry:

	2007	2008	2009	2010F	2011F
£m	34	45	46	54	54

As you will see, the betting industry and the Recommendations do to a degree exaggerate the increases in rights fees. Some of the underlying reasons for the increase are laid out above, in addition to the expansion of the Fixture List over the period. Finally in this area, we believe that the inclusion of 2012/13 figures within Table 4 are not relevant for the Determination of the 50th Levy Scheme.

Against this backdrop there has also been a very substantial fall in income from the sale of terrestrial rights to BBC and Channel 4, from £12.5m in 2001 to less than 20% of that level in 2010. The betting industry receives a very considerable benefit from this television coverage.

<u>Conclusion</u>

Racing has a compelling short term need for the loopholes to be addressed in order to achieve a fair Levy return. We commend our approach above to you.

We are also focussed on working with you and colleagues on the future, as has been referenced in statements by you and Ministerial colleagues. As we have advocated repeatedly, we want to devote our energies to achieving a long term, modern approach.

Yours sincerely

Paul Roy	**Ian Barlow**	**Paul Dixon**
<u>British Horseracing Authority</u>	<u>Racecourse Association</u>	<u>Racehorse Owners Association</u>