



16 December 2009

Gambling Inquiry
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Gambling Inquiry – Racing NSW Submission

Please find attached a submission to the Gambling Inquiry in
behalf of the Board of Racing NSW.

Yours sincerely
RACING NSW

P N V'LANDYS
CHIEF EXECUTIVE

PRODUCTIVITY COMMISSION – DRAFT REPORT ON GAMBLING RACING NSW'S RESPONSE

Introduction

Racing NSW thanks the Commission for extending an invitation to it to make a further submission in respect of the draft report on gambling. This submission will supplement the evidence given by the Chairman and Chief Executive of Racing NSW at the Commission's Public Hearings in Sydney on 1 December 2009. The submission should also be considered in conjunction with Racing NSW's original submission to the Commission.

This further submission is confined to the findings and recommendations contained in Chapters 12 and 13 of the Commission's draft report and while Racing NSW agrees with certain facets of the Commission's draft report there are other matters which cause it considerable concern.

The Commission accepts that racing and wagering are inextricably linked, with each at least partly dependant on the other. What it does not recognise however is that racing is a very large industry providing employment opportunities for thousands of people whereas wagering is a subsidiary activity which is almost totally reliant on the racing industry for its existence.

Racing NSW believes therefore that the Commission's draft report appears to concentrate more heavily on the interests of wagering operators, particularly those claiming to be low margin operators, and what it incorrectly perceives as the bulk of consumers (recreational punters) rather than on the interests of the racing industry and the many thousands of persons who derive all or part of their livelihoods from the industry.

It is the contention of Racing NSW that the implementation of the Commission's recommendations in their entirety would have a substantial negative impact on the industry and on the financial welfare of the industry's participants.

More importantly, Racing NSW is not convinced that the recommendations would necessarily be of benefit to the majority of consumers. To this end Racing NSW believes that the recommendations will facilitate the transfer of revenue from the racing industry to low margin wagering operators and

professional punters without providing any real benefits for the overwhelming majority of punters.

Racing NSW is also concerned that many of the Commission's assumptions appear to be based on statements and opinions proffered by a wide array of commentators without any factual information or in-depth and robust analysis having been undertaken to either test or support those opinions. By way of example, the Commission quotes several persons to support its assertion that the totalizator monopolies have not been in the interests of the racing industry, an assertion totally rejected by Australian racing administrators. Those quotes are simply opinions not supported by fact. In addition, no industry leader is quoted in rebuttal.

If the Commission were to undertake a background check on at least one of the organizations quoted in its report, it would find that it is comprised of no more than a handful of individuals who have appointed themselves to executive positions and then professed to speak on behalf of the hundreds of thousands of punters throughout Australia.

The organization has no official recognition from any racing authority or race club nor, we understand, from any State Government. Furthermore it has no credibility amongst the major wagering operators. Its views and the views of other individuals mentioned in the report are in the extreme and are far removed from those of the mainstream of Australian punters.

Racing NSW believes that the credibility of the Commission's report will be questionable at best if it continues to base any of its findings and recommendations on the radical views of several persons quoted in the draft report.

We will now deal with each of the Commission's findings and recommendations in sequential order.

Chapter 12 - Interactive Gambling Act 2001

Racing NSW is surprised by and disagrees with the Commission's recommendation to repeal the Interactive Gambling Act. In fact in our initial submission we recommended that the Commission support a strengthening of the legislation.

Racing NSW is of the opinion that the legislation has been effective and further believes that any relaxation of the current prohibitions would have serious social consequences because of the upsurge in problem gambling which would follow.

For the reasons which will be covered in our response to Chapter 13, Racing NSW doubts the feasibility of the Commonwealth and the State and Territory Governments reaching agreement on common standards and regulations in respect of on-line gambling providers.

History has shown us that some jurisdictions will always seek to operate on a unilateral basis so as to obtain an advantage for that particular State or Territory. In addition, even if it were possible to facilitate a national regulatory scheme, Racing NSW believes that such scheme would prove to be unenforceable on overseas gaming operators without the benefit of legislation such as the Interactive Gambling Act.

In the circumstances, Racing NSW reiterates its earlier recommendation that the Commission support a strengthening of the legislation by making it an offence for an overseas wagering operator to provide wagering services to Australian residents and by also introducing legislation making it an offence for an Australian licensed financial institution to process deposits and withdrawals between Australian punters and overseas wagering operators.

Chapter 13 - Developments in the racing and wagering industries

13.1 The legacy of traditional funding arrangements on wagering and racing

Race Field Legislation

Racing NSW supports the Commission's finding that in the absence of regulation, free-riding by wagering providers would undermine the racing industry and harm consumers of wagering products. However, the harm caused to the racing industry by wagering operators free riding on the industry's product will not be overcome by the imposition of low fees based on the operators' gross profit as suggested by the Commission.

As pointed out in our initial submission it was for this very reason that the NSW Government introduced its race Field Legislation. While that

legislation provides a mechanism to ensure that all operators using NSW race fields for their wagering operations contribute towards the costs associated with the running of the industry it does not fully compensate for the significant transfer of wagering activity from New South Wales to low margin operators based in low tax or tax free jurisdictions in Australia.

In that respect it is stressed that race field fees are payable only in respect of wagering on NSW racing events while transferred investments relate to wagering by NSW residents on all racing events, no matter where those events are held outside New South Wales.

We do not agree that the state-based legislation poses any risks for effective competition in wagering nor do we agree with the Commission's assertion that the state-focused regulatory approach potentially allows racing authorities to structure the product fees to defend the status quo funding arrangements with TAB's.

The legislation was introduced to ensure that the NSW thoroughbred racing industry was adequately compensated for the use of its racing product and in implementing the scheme, Racing NSW applied the same level of fees on all operators, irrespective of where they were located or what form of wagering activity they conducted.

The operating margin of those operators is ultimately a matter for each of them to independently determine. This should then be the governing factor in determining competition between different operators.

This is no different to the situation which exists in most other commercial enterprises. The petrol industry can be used as an analogy. In that industry the petrol companies charge all independent operators the same price for petrol. Those operators are then free to set their selling price dependent on the margin they wish to achieve. This then provides competition between the operators.

As the Commission would be aware Racing NSW's fee structure is currently the subject of two actions in the Federal Court of Australia and the outcome of those cases will largely determine the future application of the legislation.

Financing the Industry – The Role of Owners

In respect of the Commission's suggestion that punters ultimately finance the industry, we wish to dispel a myth that the industry's only source of funding is from wagering operators and punters. Although receipts from wagering operators account for approximately 70% of the industry's direct revenues (the remainder coming from the other commercial operations of race clubs) it must be pointed out that racehorse owners contribute a far greater amount.

The most important internationally recognised measure of success of a racing jurisdiction is to compare the return to owners as a group with the costs that group of owners incurred to have their horses compete (training costs, agistment, vet, float fees, etc).

In New South Wales, the annual cost to owners to have their horses compete is \$220 million. As a group owners receive \$100 million in net returns (after 15% is taken out for trainers and jockeys).

Accordingly, just on the costs to compete, owners in New South Wales only receive back 45% of their costs.

It should be stressed that these figures do not include the capital cost of the horses, currently estimated at \$500 million per annum so no amortisation costs have been provided for.

The returns in New South Wales fall well short of other international racing jurisdictions such as Hong Kong and Singapore where up to 100% of the owners' competition costs are returned as prizemoney.

By any measure it must be recognised that racehorse owners in New South Wales are in fact the largest contributors to the industry.

Owners are therefore pivotal to the prosperity of thoroughbred racing and in the event that returns to owners are further diminished it could be anticipated that the incentive to purchase and race horses would also be reduced. It has been established that betting opportunities for punters are maximised with race fields of 12 because of the wider spread of possible outcomes in the race. This then leads to a maximisation of turnover and hence revenue.

A loss of owners in the industry would lead to an overall reduction in the number of horses available to compete at race meetings with a detrimental effect on the quality and quantity of racing. Apart from the adverse effects on the industry, this downward spiral would also be to the detriment of punters and wagering operators who rely on strong and competitive field sizes and the integrity of racing administration to support their betting activities.

Size of Racing Industry

Racing NSW must also question the inference contained in the Commission's report that the industry in New South Wales (and in Australia) is too large and exceeds what the consumer is willing to pay for.

By its own admission the Commission has indicated that its Inquiry was restricted to gambling, not to the racing industry per se. Accordingly, there would have been very little factual information placed before the Commission to substantiate any opinions along those lines.

The Racing Industry should not be seen solely as a vehicle on which wagering operators and consumers transact business by making wagers.

Beyond the livelihoods of participants, racing also enriches the wider community on several levels:

- State taxation of wagering delivers social benefits by expanding consolidated revenue which is directed to a wide array of public facilities and services, including schools, hospitals etc.
- The entertainment value of racing is widely appreciated by the community. Apart from racegoers attending meetings, citizens nationwide rely on broadcasts of racing for daily entertainment.
- Since colonisation, race days and the opportunity they bring for volunteers to contribute to their local communities remain a treasured part of Australia's social fabric.
- Often the local "Cup" day is the biggest event of the year, especially in remote communities.

- In NSW alone there are 122 racecourses, nearly all of which have been established for 100-150 years.

As stated by the Chairman of Racing NSW during the public hearings in Sydney, the Racing Industry constantly reviews its operations to ensure that it is operating at peak efficiency.

In addition, Racing NSW wishes to dispel the presumption that the rationalisation of smaller country tracks, which cater for a minimum of race meetings, would be in the overall financial interests of the industry. A financial analysis of the operations of these clubs shows that they are in fact net contributors to the industry because of the voluntary manner in which they function coupled with the significant support they receive from their local communities.

The continued operation of these smaller centres is also vital in providing opportunities for horses of a certain class as well as contributing towards the livelihoods of country trainers and jockeys.

Certain commentators suggest that there is too much low quality racing being conducted that no-one wants. This is very much a minority view and Racing NSW believes that it is the consumers who ultimately decide whether or not to support certain venues and certain classes of racing. At the present time provincial and country thoroughbred race meetings in New South Wales account for 50% of wagering turnover.

Therefore, so long as they continue to receive support from punters, Racing NSW will continue to provide for the existing programme of race meetings.

Furthermore, as the racing landscape continues to evolve with the breakdown of the "Gentlemen's Agreement" it will become more imperative that each State provides a maximum of local content on which punters are able to wager.

Draft Recommendation 13.1 - National Funding Model

It should be stressed that in its original submission Racing NSW supported a national framework for the application of race field legislation so as to ensure its constitutionality. Racing NSW also supports the need for Federal legislation to control the national e-commerce border so product fee

avoidance and financial/racing integrity risks posed by offshore wagering operators are managed.

This did not infer however that Racing NSW supported the implementation of a national funding model along the lines suggested by the Commission.

In fact, Racing NSW is not convinced that a national funding model would address the issue of free-riding by wagering operators. Furthermore, Racing NSW would be concerned if the interests of the industry were ignored and if a national funding model were based on the lowest common denominator, in other words if the level of fees charged to wagering operators was based on the lowest fee currently levied by any individual jurisdiction, or a fee negotiated.

This would lead to a massive downturn in the industry's financial viability. This has occurred in other racing countries, namely the United Kingdom and that experience must be avoided at all costs.

As identified by the Commission itself, the current state-based race field legislation already overcomes the problem of free-riding and (subject to the outcome of the proceedings before the Federal Court) Racing NSW believes that race field legislation remains the most appropriate method of ensuring that all wagering operators contribute equally towards the costs associated with maintaining the industry.

Wagering operators and punters alike expect the industry to be robust and operate with the maximum of integrity. The costs of maintaining the industry however are extremely high.

Irrespective of our views on the matter we would point to the many previous attempts by State and Territory Governments over the past 15 to 20 years to develop and implement national approaches to the issues of wagering and industry funding. To date not one of these attempts has resulted in a consensus position being reached.

As the implementation of a national funding model as suggested by the Commission would require agreement between the Governments and racing industries of all eight Australian States and territories as well as input from the Federal Government we remain sceptical that such agreement could ever be reached.

Industry Agreements

Insofar as replacing all existing product fees with a national model is concerned we would point out that the current product fees charged to this State's totalizator operator are governed by a series of contractual agreements backed up by statute.

These agreements are extremely complex contracts entered into between independent parties on an arms-length basis following extensive negotiations – with extensive “trade-offs” and inter-linkages between various aspects of those contracts which make it impossible to accurately or fairly encapsulate the relationship between the parties by reference to a simple or simplistic formula.

It would be totally inappropriate and impractical for these commercial agreements to be amended or put aside other than by agreement by all parties and any attempt to do so by legislative intervention would raise serious and fundamental concerns regarding “sovereign risk” and the certainty of any commercial contracts in Australia.

Even so, as the arrangements were entered into in good faith with a view of ensuring the long term financial welfare of the industry, it would be essential that any changes to those arrangements do not result in the industry being worse off.

Gross Profit vs. Turnover

As to the Commission's suggestion that any new product fee model should be based on a gross profit method we would refer you to our initial submission in which we explained why we adopted a race field fee based on turnover rather than one based on gross profit.

We see no reason to now alter our view.

That issue is currently being argued in the Federal Court Proceedings between Betfair and Racing NSW and we invite the Commission to consider the submissions by our Counsel and of the NSW Attorney General about why turnover is a much more appropriate method.

Importantly, under a gross revenue model the industry would have no certainty and would be required to rely on the wagering operators' business model, operating efficiency and risk management policies for its revenue. This point was commented upon by Perram J during the above Court proceedings.

A further argument against the use of gross revenue to determine industry payments is the difficulty in assessing such revenue. In this respect these difficulties were highlighted in the current Federal Court proceedings when it was pointed out that Betfair's gross revenue (its commission) does not include the revenue it receives from a number of fees, including premium charge, excess transaction charge, API license fee and data access fee. This highlights Racing NSW's contention that a fee based on gross revenue can be manipulated by the wagering operator.

Racing NSW also wishes to take issue with a further assumption made by the Commission on this matter.

The Commission attempted to quantify the effect on each type of operator of the 1.5% turnover levy imposed by Racing NSW using the same flawed arguments advanced by the corporate bookmakers and Betfair.

The Commission states that the 1.5 % levy is equivalent to 9.4% of the TAB's gross revenue based on an average take-out rate of 16% and compares it with the effect of the levy on low margin operators. This is a simplistic argument as it conveniently overlooks the considerable State taxes and Industry product fees which Tabcorp is already paying.

These levies and taxes total 67% of Tabcorp's gross profit, a fact acknowledged by the Chief Executive of Betfair during his appearance in the Federal Court on 23 November 2009.

Accordingly, the imposition of the 1.5% levy on Tabcorp has a far greater effect than that portrayed in the Commission's report and places Tabcorp in a similar position to that of the other operators.

Further, the alleged impact on Betfair of a fee based on gross revenue (allegedly 60%) cannot be made out as Betfair fails to disclose all of the revenue it receives from each bet or the financial benefits it accrues from cross selling. In this regard apart from conducting a betting exchange, Betfair also acts as an agent for the Tasmanian Tote and the Corporate

Bookmaker "Sports Alive". This cross selling allows Betfair to award "Betfair Points" to persons making bets through these agency agreements which can then be used to reduce the cost of bets made through the betting exchange thereby reducing any fee paid on gross revenue.

Turnover has long been recognised in Australia as an appropriate method of levying wagering operators with the respective State Governments and racing authorities imposing turnover taxes and levies on bookmakers over a long period.

In addition the turnover method is recognised internationally with Australian totalizator operators being required to pay a turnover levy of 3% on their totalizator and fixed odds business when covering racing from Hong Kong, Japan, New Zealand and several other countries. The same situation applies in the United States where a turnover levy of 3% is charged between State racing authorities.

Turnover levies are not unique to the racing industry as turnover is also the recognised method of applying taxes or levies in many other industries, such as alcohol, tobacco and petrol.

In support of its contention that gross revenue is the most appropriate method of levying wagering operators, the Commission has referred to the decisions of the Victorian and South Australian authorities. However, universal support for this method does not exist in Victoria where many bodies, including the major race clubs, have expressed their preference for the turnover method.

Be that as it may, any reduction in revenue to the Victorian racing industry can be more readily absorbed in that State as compared to New South Wales because of the favourable position the Victorian industry enjoys with its annual revenue stream of \$80 million from the operation of poker machines in Victoria.

Racing NSW rejects the Commission's suggestion that turnover based fees will drive operators out of business. The NSW fees have now been in operation for over 12 months and there has been no evidence of any wagering operator ceasing its activities or drastically altering its business models.

In fact during the Federal Court proceedings in the case of Betfair Vs Racing NSW, the Chief Executive of Betfair admitted that the Racing NSW fees had had no effect on any of the following matters:

- The number and type of NSW thoroughbred races on which Betfair offers services,
- The structure of the commissions or the actual commissions charged by Betfair,
- The odds offered through Betfair's Exchange,
- The amount spent by Betfair on marketing,
- The volume of back bet turnover achieved by Betfair,
- The gross revenue achieved by Betfair, and
- The competition between Betfair and its competitors.

Furthermore, by taking advantage of the cross selling mentioned earlier, Betfair is able to attract patronage to its full suite of products (including high margin totalizator operations) when a person makes a bet with the betting exchange. This is similar to a newsagency where the agent is required to pay 75% of his gross profit on the sale of newspapers to the publisher but relies on a customer purchasing other products with higher margins such as magazines and greeting cards when he purchase a newspaper.

Racing NSW also disagrees strongly with and questions the legal basis behind the Commission's assertion that the recent decision of the Victorian Supreme Court in respect of the uncertainty of gross revenue would apply equally to the turnover method of levying fees. The NSW legislation is quite different to the Victorian legislation and there has been no challenge similar to that which occurred in Victoria.

Independent Pricing Panel

Finally, Racing NSW has great difficulty with the concept of an independent body being given the responsibility for setting and reviewing racing industry levies with the object of maximising long-term consumer interests.

To suggest that the industry's prices be established by a body similar to IPART would be inconceivable. IPART is an independent body that oversees regulation of the water, gas, electricity and public transport industries in New South Wales and its primary purpose is to regulate the maximum prices charged for monopoly services by government utilities.

The Racing industry is a private enterprise not a Government utility and it does not provide services for or on behalf of the Government.

Racing NSW has the responsibility for overseeing the business, economic development and strategic development of the horse racing industry in New South Wales and initiating, developing and implementing policies considered conducive to the promotion, strategic development and welfare of the horse racing industry in the State as well as protecting the public interest as it relates to the horse racing industry.

It would be ludicrous to suggest that it could undertake this role without the ability to control the industry's revenue streams.

If a so-called independent body were to be given responsibility for setting one aspect of the industry's financial structure, namely the price wagering operators pay for using the industry's product then why wouldn't it also be responsible for setting the operating margins of totalizators, bookmakers and betting exchanges or even setting admission and catering prices for race clubs or training and riding fees for trainers and jockeys and fees charged by stallion owners. It is clearly an inappropriate proposition.

As is the case with any other private sector industry, the racing industry as the producer of the racing product should retain the right to set its own price. That price should take into account the interests of the wider industry and not be confined solely to the interests of wagering operators and professional punters.

In this regard it is pointed out that Racing NSW has the statutory responsibility of implementing policies designed to ensure the well-being of the NSW racing industry and its participants. It is not responsible for ensuring the livelihoods and incomes of the myriad of wagering operators now entering the market.

Independent bodies are not set up to determine the price of most other commercial goods and services throughout the community. Why then should the racing industry be treated any differently?

Draft Recommendation 13.2 - Sky Channel

Racing NSW offers no comment on this recommendation at this time other than to say that it would be concerned if any changes to broadcasting arrangements resulted in a lesser and inferior coverage of racing events which ultimately led to a decrease in consumer interest and betting activity.

Draft Finding 13.2 – Co-operative Taxation Arrangements

Racing NSW fully supports the proposition that Governments cooperate when setting and reviewing wagering taxes.

Unfortunately, we have already witnessed what the Commission refers to as destructive tax competition by some of the smaller States and Territories. It could also be referred to as a classic case of “the race to the bottom”.

The Northern Territory Government started that race when it established its corporate bookmaker regime and imposed a miniscule tax of 0.33% on their turnovers. This then led to other States and Territories reducing and eventually repealing their respective bookmaker taxes. It is understood that the Northern Territory Government has now abolished altogether its tax on bookmakers.

A further example of this destructive competition can be found in the decision of the Tasmanian Government to eliminate all taxes on local wagering operators, including the Tasmanian Tote. This has enabled that organisation to embark on a significant rebate scheme aimed at attracting key interstate customers and professional punters, thereby forcing mainland TAB's to also offer some form of rebates to larger investors.

Two issues follow from these actions.

Firstly the rebate schemes provide no advantage for the average customers who make up the bulk of totalizator investments as they are aimed specifically at the very large professional punters. In fact the favoured few are being given an unfair advantage over ordinary punters. This is in itself contrary to the principal of pari-mutual betting where all punters receive an equal dividend and their return is governed only by the size of their investments.

Secondly, the Tasmanian Tote is only able to pursue this policy because of its ability to merge its investments into the larger SuperTAB pool, a privilege which we believe it is abusing. To this end the pooling agreements were entered into to allow residents of Tasmania to benefit by being able to bet into a larger more stable pool. It was not entered into to allow the Tasmanian totalizator to attract customers from the very State which allowed it to pool its investments.

The practice also allows bookmakers offering tote-odds betting to attract punters who would otherwise bet with the larger totalizator operators then lay-off those bets into the totalizator system via the Tasmanian Tote while at the same time receiving a significant commission or rebate.

By diverting investments from one totalizator to another, corporate bookmakers are able generate revenue for themselves at the expense of recreational punters and the racing industry which would have otherwise received income from the totalizator in its own jurisdiction.

There is very little advantage in these transactions for the majority of consumers who are recreational punters. However, racing industry participants in the larger States are being deprived of a source of revenue.

As identified earlier, previous attempts to obtain unanimity between the States and Territories on taxation and industry funding matters have failed. Several years ago a meeting was held between officials from the various State and Territory Treasuries and Racing Departments to address taxation and industry funding. No consensus was reached at that meeting.

Heads of State and Territory Treasuries met again earlier this year to discuss these issues. At the time of preparing this submission Racing NSW is not aware of any public statement emanating from that meeting.

With regard to competition from lowly taxed off-shore operators, Racing NSW believes that this competition should not be used in itself as an excuse to abandon the taxation of wagering activities. Rather, Racing NSW stands by its earlier submission in which it recommended amendments to the Interactive Gambling Act 2001 to provide for the reinstatement of prohibitions which prevent overseas operators from providing wagering services to Australian residents and also introducing legislation making it a criminal offence for an Australian licensed financial institution to process

deposits and withdrawals between Australian punters and overseas wagering operators.

In addition, NSW Race Field legislation also requires compliance by off-shore operators. Non-compliance with this legislation by existing Australian operators who may transfer their operations off-shore would expose them to severe sanctions, including heavy fines and custodial penalties.

Accordingly, as most, if not all, corporate bookmakers are Australian residents they would leave themselves open to jail sentences and heavy fines in the event that they returned to Australia.

Draft Finding 13.3 - Tote-Odds Betting

Tote-odds betting offered by bookmakers in certain jurisdictions provides a customer with odds which are not fixed, but rather determined by reference to the final odds on nominated totalizators. In many cases, "tote-odds betting" is offered at the highest odds of any of the three main TABs (i.e. NSW TAB, UNITAB and SuperTAB) or at a premium to TAB dividends.

Such products therefore directly target totalizator customers and do so by "free riding" on the commercial investment which TABs have made in their totalizator operations. Bookmakers who offer "tote-odds betting" do not have to pay the same wagering taxes and fees to the racing industry as the totalizator operators or invest in the systems and distribution required for a totalizator operation.

Tote odds are the intellectual property of the totalizator operators and they should not be made available for free for competitors merely to heighten the latter's capacity to compete.

This obvious market inefficiency derived from jurisdictional abuse within the Commonwealth should be a primary object of the Productivity Commission's attention and Racing NSW believes that this inquiry should turn its attention to finding a remedy for such inequities.

As mentioned earlier many bookmakers offering this form of betting are merely facilitating the transfer of investments from larger totalizator operators to smaller operators to the detriment of the racing industry and its participants in the larger jurisdictions without any benefit for the bulk of recreational punters.

We have not altered our view on this matter and as we indicated in our previous submission we firmly believe that there should be a prohibition against the offering of totalizator odds betting by persons other than licensed totalizator operators and unless that operator was actually conducting a totalizator.

Draft Finding 13.4 – Offering of Inducements to gamble

It is our understanding that the NSW legislation currently prohibits the advertising of inducements to gamble such as free bets, etc. rather than prohibiting the actual offering of the free bets.

We agree with the Commission that an assessment be undertaken into the attendant risks for problem gamblers followed if possible by the implementation of a nationally consistent approach.

Draft Finding 13.5 – TAB Retail Exclusivity

Racing NSW does not agree with the Commission's finding in respect of TAB retail exclusivity.

The NSW TAB was privatised in 1997 following a series of complex and protracted negotiations between the NSW Government, the NSW Racing Industry and the TAB. The agreements reached between these parties were then given statutory recognition in legislation enacted by the NSW Parliament.

The TAB was then floated on the Australian Stock Exchange with "mum and dad" investors along with retail investors encouraged to participate in a float which raised approximately \$1 billion for NSW taxpayers.

The sale also underpinned the industry's future funding arrangements and gave it the degree of certainty needed to enter into the contractual agreements mentioned earlier.

At the time the TAB was privatised there was recognition that remote betting via the internet and telephone would be subject to competition from NSW bookmakers and interstate wagering operators. However, it would be fair to say that investors were encouraged to purchase TAB shares and the industry was comfortable to enter into its commercial agreements in the belief that TAB would retain its retail exclusivity.

The cost of maintaining Tabcorp's retail network is significant with the cost of selling bets greatly exceeding the costs involved in the selling of bets through other medium. Any action which reduced Tabcorp's turnover through its retail network would increase its costs and lead to a possible closure of agencies as occurred throughout Australia in the banking industry. This would not be in the interests of recreational punters.

The majority of recreational punters place their bets through Tabcorp's retail network of TAB agencies, hotels and registered clubs. On the other hand, professional and more sophisticated punters spread their investments over the full range of betting outlets (TAB's, bookmakers and betting exchanges) by means of remote access (telephone and internet).

Because corporate bookmakers cater for the more educated punters they are forced to operate on margins of 5% to 6%. This contrasts with the United Kingdom where bookmakers have access to the retail market. As a result they are able to operate with margins in excess of 11%. It is obvious therefore that bookmakers and betting exchanges would seek to break down Tabcorp's retail exclusivity and access the recreational punters who wager through that medium.

If Tabcorp were to lose its retail exclusivity there is little doubt that a significant portion of its turnover would be transferred to competing operators thereby affecting its overall liquidity which is essential for it to be able to maintain stable pools. This would cause significant fluctuations in totalizator dividends thereby adversely affecting consumers.

70% of Tabcorp's wagering turnover is now derived through its retail network and if that source of revenue was jeopardised as a result of TAB losing its retail exclusivity then the value of investors' shareholdings would be seriously devalued and the industry's continued viability would be threatened.

This could then possibly lead to a series of compensation claims against the NSW Government which could have adverse effects on all NSW taxpayers.

General

Racing NSW would like to address several other issues which it believes should be considered by the Commission when preparing its final report.

Low Margin Operations

Firstly, there appears to be a view that low margin operators provide greater returns for the consumer.

Racing NSW does not agree that this is always necessarily the case and believes that the concept that the low margin operators provide better overall value for the majority of punter is purely illusory.

What is happening is that the professional punter and the new breed of wagering operators are exploiting the majority of punters who fall into the category of recreational punters.

Recreational punters bet purely for entertainment with the hope of winning additional monies whereas Professional educated punters and low margin wagering operators punt to generate all or part of their income. Recreational punters account for up to 90% of wagering turnover.

The majority of recreational punters bet through tote pools. For example in NSW alone recreational punters as a group betting through the totalizator system lose \$800 million per year.

As 60-70% of Corporate Bookmakers turnover is comprised of tote odds betting those bookmakers have in essence become commission agents. They have then negotiated to receive a rebate of up to 7% of turnover from the tote operators, particularly those in the smaller States where their pool is merged with the pools sourced from one of the larger States.

Accordingly these Corporate Bookmakers betting tote odds can't lose as they don't take a position and are receiving a rebate of up to 7% of the bet, whereas the punter is no better off as he is still being paid the dividend declared by the totalizator operator.

A further example of the illusion of low margin operators can be found in the operations of the betting exchange "Betfair". In this regard:

- Betfair has consistently claimed that punters are better off betting with its exchange than they are in betting with TAB's because their operating margin ranges from between 3% to 5% compared with the TAB's average margins of 16%.
- This would imply that on aggregate Betfair customers receive 95% to 97% of their investments back as winnings compared with TAB punters who receive 84%.
- However, in the Federal Court proceedings between Betfair and Racing NSW, the Chief Executive of Betfair, Mr. Andrew Twaits, conceded that back bet customers (punters backing horses to win) received only 80% of their aggregate turnover back in the form of winnings.
- Based on Betfair's own figures winning punters would then be required to then pay a further commission to Betfair of 3% to 5%, thereby reducing their net returns to between 75% and 77%. These returns could be further reduced by Betfair's premium charges.
- These returns compare unfavourably with the return provided by the TAB of 84% and the 94% return attributed to bookmakers.
- While the Commission may accept the argument that this is off-set by customers who are laying runners on the exchange, i.e. backing horses to lose, Racing NSW believes that persons laying runners on Betfair are very much in the minority and could be equated more to unlicensed bookmakers and professional punters than to the average recreational punters.
- The margin that these persons are receiving would equate to 20% of the turnover being invested by ordinary punters.
- Persons laying runners on a betting exchange are in a much more favourable position than bookmakers, particularly those on the racecourse, because rather than being required to quote a price on every runner in the race, they can pick and chose the races on which they wish to operate and the runners against which they wish to bet.
- The extra charges imposed by Betfair, such as its premium charge, etc., result in the costs to the customer exceeding the advertised commission rates of between 3 and 5%. This is similar to the situation which formerly

existed in the banking industry when various hidden charges increased the effective interest rates for borrowers.

Elasticity of Wagering

This brings us then to the so called elasticity of wagering. For many years racing industry pundits and self appointed experts have argued the case for totalizator commission rates to be lowered. The argument has been that by lowering the rates dividends will be increased and therefore turnover and revenue will be increased.

This is a simplistic argument and has not been based on factual information or in-depth analysis. The proponents of the argument have in the past quoted examples from highly taxed regimes with extremely high take-out rates where all incentive to bet was eroded. It was obvious that significant reductions in the take-out rates in such circumstances would improve turnover and revenue.

The same situation does not apply in New South Wales and the other Australian jurisdictions which already have low commission rates by comparison with other countries. By way of example the average commission rate in Australia is 16% compared with 25% in the major racing centres of France and Japan.

To date all experiments on reducing the commission rates have failed to increase turnover to a level sufficient to offset the revenue foregone as a result of the lower rates.

By way of example the following table illustrates the effect of reducing the existing commission rate for TAB's win betting by 1% increments. The 2004/05 turnover figures are used as the base.

Win Turnov er	W&P Commissi on Rate	Gross Revenue	Forgone revenue	Turnover required to offset forgone revenue	Incr	Increas e in amount availabl e for dividen d
\$	%	\$	\$	\$	%	%
2.34 billion	14.50	339,000,0 00	0	0		0
	13.50	316,000,0 00	23,400,00 0	173,000,00 0	7.41	1.17
	12.50	293,000,0 00	46,800,00 0	374,000,00 0	16.0 0	2.34
	11.50	269,000,0 00	70,200,00 0	610,000,00 0	26.0 9	3.51
	10.50	246,000,0 00	93,600,00 0	891,000,00 0	38.1 0	4.68
	9.50	222,000,0 00	117,000,0 00	1,232,000,0 00	52.6 3	5.85

Based on a turnover of \$2.34 billion on the win totalizator a reduction of commission from 14.5% to 9.5% (31% reduction) would increase the amount available for dividends by a mere 5.85%. However, an increase in betting turnover of approximately 50% (\$1.23 billion) would be required to off-set the loss of revenue.

There is also a view that the ultimate beneficiaries of the reduction would not be the average recreational punters but the larger professional and arbitrage punters.

Based on these figures for totalizator operations it is difficult to accept the argument that a transfer of investments from a totalizator system to a bookmaking system with a margin of 5% to 6% would result in a net increase in revenue.

Racing NSW contends that under any low margin operation it is not the average recreational punter who benefits from the low margins, but the

handful of professional and more sophisticated punters to whom variations in margins have a significant effect.

In this regard Racing NSW holds that the average recreational punters are unaffected by margins. We believe that over a given period they will on aggregate lose a certain amount irrespective of the operator's margin. The recreation punters' losses are then shared between the wagering operators, professional punters, the State and federal Governments and the racing Industry.

In other words what is occurring as a result of investments being transferred from high margin totalizator operations to low margin bookmaking operations is that revenue is being transferred from the racing industry and its participants to a handful of bookmaking firms and professional punters without any flow on benefit to the average recreational punter.

This is one of the factors which have all but ruined the racing industry in the United Kingdom where low margin bookmakers are the dominant wagering medium.

Despite achieving very high turnovers on their various operations, British wagering operators contribute very little to the racing industry by way of revenue. Earlier in this submission we made mention of the fact that racehorse owners in New South Wales receive 45% of their costs back as prizemoney. In the United Kingdom owners receive less than 25% of their costs.

The United Kingdom racing industry is facing serious financial issues and is reliant for its continued viability on the on-going support of Middle Eastern royalty.

Yet the United Kingdom is often put up as an ideal model on which Australia should base its racing industry and is the very model which the Productivity Commission appears to be suggesting for Australia.

Accordingly, we would strongly suggest that rather than relying on uniformed comment from persons with vested interests, the Commission should undertake its own detailed analysis of the wagering and industry funding models in the United Kingdom.

New Forms of Betting

It is constantly stated that the new breed of wagering operator (corporate bookmakers and betting exchanges) are providing punters with new and innovative forms of betting opportunities.

Racing NSW disputes this suggestion.

Corporate bookmakers are offering fixed odds betting (including best fluctuation and starting price odds) and tote odds betting. There is nothing new or innovative about these products.

Fixed odds betting has been available for centuries and the other derivatives of fixed odds betting have been available on Australian racecourses for most of the last century.

Tote Odds betting is merely an offer to pay winning customers on the basis of a declared totalizator dividend and the only variation from the product offered by the totalizator operators themselves is the offer to pay a return based on the higher of the dividends declared between the three totalizator pools. This is only possible because of the existence of three separate totalizator pools in Australia and the opportunity to offer this product would cease in the event of a national totalizator pool being formed.

Similarly there is nothing new or innovative about the product offered by betting exchanges. In this regard the majority of punters are merely placing bets on horses to win at fixed odds while a minority are taking the role of the traditional bookmakers and backing horses at fixed odds to lose.

The Commission argues that some of the growth in corporate bookmakers is as a result of punters switching from one wagering product to another. Racing NSW contends however that the product has remained the same but that punters have switched from one wagering operator to another where the latter is required to pay little or no State taxes or any product fees to the racing industry.

Conclusion

Finally, Racing NSW does acknowledge that the wagering landscape in Australia has changed considerably over the last 15 years. It does not however accept that those changes have been for the betterment of the racing industry.

The various State and Territory TAB's were established after the conduct of high level inquiries, in most cases by the convening of Royal Commissions of Inquiry. Those inquiries concluded that the most effective means of legalising off course betting was per medium of off-course totalizators rather than by the licensing of off-course bookmakers.

Under these arrangements, the racing industries in each of the States and Territories remained viable. In addition, State and Territory Governments were able to collect revenue in the order of billions of dollars to be used for worthwhile community services.

Unfortunately, in an attempt to create 100 or so new jobs in their respective States and Territories by licensing betting exchanges and corporate bookmakers, the Governments of certain small jurisdictions have in fact jeopardised the jobs of tens of thousands of racing industry participants, many of whom are located in regional areas throughout New South Wales.

Racing NSW is concerned that the implementation of the Commission's recommendations will lead to an irreversible decline in the racing industry's viability by further accentuating those problems.

Of particular concern to Racing NSW is the fact that the Commission's draft report as it relates to racing and wagering appears to have been prepared without the necessary analysis and research which would normally accompany a major inquiry such as this. Furthermore many of the Commission's findings are based on untested opinions offered by a range of commentators and persons with obvious self-interest who are not necessarily qualified to give such opinions.

Accordingly, Racing NSW urges the Commission to fully analyse and test the information on which it has based its findings and recommendations regarding racing and wagering before issuing a report which could have a profound effect on the racing industry.