



Email Transmission

14 January 2010

Mr G Banks
Chairman
Productivity Commission
Level 2
15 Moore Street
Canberra

Dear Mr Banks

**Re: Response by National Horse Racing Alliance
to the Productivity Commission's Draft Report on gambling**

A. Introduction

The National Horse Racing Alliance (“**NHRA**”) originated at a racing industry meeting held in Sydney in July 2009, attended by the owners of over 3,000 racehorses as well as a large cross section of other racing industry participants.

That meeting gave its conveners a mandate to form a new industry body to represent Participants on matters of national significance. A working party was formed for this purpose, resulting in the formation of the NHRA. We are a national lobby group. Our current mission is to protect the funding base of the Australian Racing Industry (“**ARI**”).

The current NHRA working party includes Mark Webster, Trevor Lobb, Phillip Esplin, Peter McGauran, Jon Freyer, John Rouse, David Moodie, Vin Cox, Richard Freedman and the writer. The list of member organizations already includes:

- * Thoroughbred Breeders Australia
- * The Thoroughbred Racehorse Owners Association
- * The NSW Trainers Association
- * William Inglis and Son Limited
- * Magic Millions Pty Ltd
- * Randwick Equine Centre
- * The Federation of Bloodstock Agents Australia



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Thus the NHRA includes representatives of horse owners, trainers, bloodstock agents, breeders and veterinarians. As the NHRA is in its infancy, the membership list continues to grow. We do not speak for race clubs, wagering operators or administrators.

We come at this point in time not as a party seeking to justify submissions we have made, but with the advantage of an understanding of the Commission's tentative views about the matters expressed in its Draft Report. Our comments are intended to be constructive, not merely critical.

Thank you for giving Martin Einfeld QC the opportunity to address the Commission on our behalf on 15 December 2009. As we represent racing participants, our interest lies primarily in Chapter 13: we believe that there are a number of major impediments to the finalization of Chapter 13 in its present form.

Our Response is in two parts:

1. In this letter, we identify a number of false assumptions on which Chapter 13 appears to be based.
2. The attached document headed "Industry Response to Productivity Commission Report on Gambling" ("**NHRA Report**"), provides a snapshot of the ARI, examines the success of Northern Hemisphere measures to prevent "free riding" and puts forward a comprehensive package of evidence based recommendations, for your consideration.

B. Internet Gambling

The Commission notes that it was asked to update its 1999 Report:

"....with a focus on problem gambling. Consistent with this, the Commission has sought to concentrate on providing evidence-based advice to Governments about which policies are likely to be the most effective in reducing the harms associated with gambling, while preserving most of the benefits" (Overview page xvii).

It is common ground that internet gambling has allowed new wagering operators to shape the future of the ARI. However, Chapter 13 appears to contain no discussion of the practical means by which governments may thwart or restrict attempts by internet operators to circumvent their laws.

The Commission appears to accept at face value the threat by the corporate bookmakers to move offshore. This assumption is implicit in two statements in the Draft Report:

“A product fee structure that disadvantages domestic online wagering companies is likely to be particularly counter-productive” (13.26)

and

“Setting the levy above (the UK levy of 10% of gross revenue) would risk movement offshore of online wagering providers to avoid the levy”. (13.32).

The NHRA supports the submission of Racing NSW that changes to the internet gaming legislation could serve to inhibit internet overseas wagering.

Moreover, our understanding is that it may be possible to implement procedures which inhibit the capacity of punters in Australia to place on overseas wagering sites and which make illegal the transfer of funds to settle unlawful transactions.

Furthermore:

1. There is no evidence of a factual nature that the potential decision of the corporates to move offshore is dictated by the size of the industry product fee, any more than it is by other factors – such as taxation and lower operating costs.
2. The experience in Europe, the UK and the music industry are dealt with in detail at Chapter 3 of the NHRA Report. These experiences offer little or no support for the Commission’s position. At least one large corporate bookmaker has already moved offshore since the levy was changed to gross profit, soon to be followed by another, namely Ladbrokes (see Alan Windross submission, footnote 9).

In the result, the Commission’s assertion that a product fee based on gross profits will prevent relocation offshore of the corporate bookmakers is speculative at best and certainly without empirical support. However, these findings are consistent with the current approach of the Commission, which appears to be to keep product fees to a minimum in order to produce the lowest possible price for the punter.

The true position is more accurately reported in an article in the Guardian Newspaper published in the UK on 8 January 2010.

Racing received a significant boost today to its campaign to force bookmakers based overseas to pay the Horserace Betting Levy following a government promise to "ensure operators taking bets on British races should pay their fair share".

Unveiling proposals that would require all overseas bookmakers to be licensed by the Gambling Commission if they want to operate in the UK, as revealed by the Guardian last month, the sports minister, Gerry Sutcliffe, promised to ensure that the requirement to pay the Levy applied to them.

"In terms of the Horserace Betting Levy, I remain firmly of the view that all operators taking bets on British races should pay their fair share. There is more to do but I am committed to making sure this happens," he said.

For more than a decade the [horse racing](#) industry has warned that a mass defection offshore by bookmakers, thereby avoiding the levy on bets in Britain which goes straight to the sport, could cripple racing's income and it claims it is now coming to pass.

The decision last year by both William Hill and Ladbrokes to move their online arms offshore has cost racing an estimated £4.2m, and the overall take from the levy on bookmakers' gross profits was £93m in 2008-09, down 20% on the previous year.

The BHA chief executive, Nic Coward, welcomed the move as a positive start to the new year for racing.

"Together we must ensure that the way in which the sport in this country is funded is right for the modern age. Of course it's right that all operators pay, wherever they are," he said.

"Offshore operators have been getting away with it for too long and racing has taken a considerable hit to its Levy income. It has also had the ever present threat of more moves offshore with potentially severe consequences. Government clearly did not intend this to happen and are now addressing it."

Under the immediate licensing proposals, which are being consulted on, all operators active in the British market would have to comply with the Gambling Act and be required to report suspicious betting activity to the commission and sport governing bodies.

They will also have to comply with British licence requirements, including the protection of children, and demonstrate how they will contribute to the research, education and treatment of problem gambling in Britain.

"The new system outlined today will also ensure that all businesses offering online gambling to our consumers adhere to our rules – not someone else's," added Sutcliffe.

While the Remote Gambling Association has said it is amenable to discussions about bringing its members under the aegis of the Gambling Commission, it is likely it will bitterly resist any move to apply the Levy.

A spokesman for Victor Chandler, one of the first bookmakers to operate offshore, said it already contributed to horse racing in the form of marketing and sponsorship.

"Because of our contributions to Racing UK and At The Races, and our commitment to the Horse Welfare Trust, we already feel we put an appropriate amount of money into racing."

Sports governing bodies, which have been lobbying for a new licensing system to combat the threat of match fixing and as a first step towards arguing for a levy on all sports bets as in France, also welcomed yesterday's Commons statement.

The 12-week consultation period, unlikely to be launched for three to four weeks, and the need for new legislation, are likely to push the issue beyond the coming general election. But racing insiders are confident that the changes have cross-party support and will be picked up by whichever party wins.

D. The ARI Is A Major Industry In its Own Right.

Term 3 of the Terms of Reference for this Inquiry has special significance. It requires the Commission to “**encourage the development of efficient and internationally competitive Australian industries**”.

The ARI is a major industry in its own right. It is a world leader on all accepted industry indicators and it is well positioned to benefit from the strong Asian market (Chapter 1, NHRA Report).

No doubt due to the Commissions’ focus generally on productivity and competition and because that focus is upon the gambling industry in this enquiry, the Draft Report tends to treat the ARI as subservient to the gambling industry, rather than as an industry in its own right. It appears to be the tentative view of the Commission that the rationale of the ARI is to exist as an adjunct to the gambling industry and not as a large scale industry “**for its own sake**”.

This approach masks the significance of the ARI to the Australian community and economy as a whole.

Even as a contributor to the gambling industry, racing’s role is a significant one. In fact, it is greater than that of lotteries, the Pools and Keno put together. (See Draft Report Overview at page xviii).

In its current form, Chapter 13 appears to accept a position that consumers (by which it means punters) are best served by the corporate bookmaker model which operates in the UK. The Draft Report then rationalizes that outcome by suggesting that the ARI may need to downsize significantly to accommodate that result.

At page 13.10, the Report asks “*Is the Australian Racing Industry too big overall?*” The ARI is said to be large by international standards (13.10.8), reflecting (according to some) a fundamental imbalance.

Suggestions are made that the industry may contract if current so-called “protective arrangements” are altered (13.13.1) and that the “correct” industry size is that which most closely represent consumers’ preferences for the number, frequency and quality of races and (it is suggested) the “odds they receive” (13.13.3).

No consideration is given in the Draft Report to the prospect of unemployment in the ARI should a search for greater competition between wagering operators ultimately constrain, rather than expand, its scope. Notwithstanding the Commission’s Terms of Reference, the only reference to unemployment in Chapter 13 is as a possible

“transitional cost” of a smaller industry (13.13). This does not satisfy the Terms of Reference.

Furthermore -

1. This part of the Draft Report relies on the views of a bookmaker, a punter and a racing journalist quoted in the Draft Report ((Eskander at 13.10, Mair and Moran at 13.12)). These people are entitled to their opinions, but their views do not represent anything like a broad or community perspective. The issue is addressed in detail in Chapter 2 of the NHRA Report.
2. The removal of protective arrangements appears to equate with the enhancement of the welfare of corporate bookmakers.
3. Whether so or not, the possibility of a consequential contracting industry may deliver the opposite outcome to consumers than that which is envisaged by the Commission, as illustrated in exhibit 6 of the NHRA Report.

A contraction in horse numbers may produce:

- (a) smaller race fields (which are poorer betting mediums);
- (b) lesser returns to consumers (punters or owners), and lower quality racing as horses migrate to jurisdictions with better prize money. This has been the experience in New Zealand with horses being transferred to Australia, and in Australia with horses transferring to Asia.
- (c) Integrity measures (such as stewards and drug testing laboratories) may be compromised by a shortage of funding, leading to a loss of confidence in the racing product.

In other words, the result may be a less attractive product, which will lead to a lower wagering turnover.

E. Who Funds The Racing Product?

At 13.23, the Draft Report states:

“..... the current state-based race field legislation overcomes(“free riding”), but poses significant risks for effective competition in wagering, potentially affecting the long term future of racing and wagering, and, more importantly, the punters who ultimately finance both of these industries”

Of course punters contribute substantially to the ARI, but the suggestion that they “***ultimately finance***” the industry is an exaggeration. This issue is examined in some detail at Chapter 2.1 of the NHRA Report, which estimates that Owners outlayed c. \$720 million in training fees and received back less than \$340 million in net prizemoney, in the 2007/08 year.

In the time available to the NHRA we have not been able to accurately estimate the net subsidy of the racing product by Breeders, who bear the cost of rearing 18,000 foals for two years, on average, before they go to sale or in to training. On balance, it is most likely that both Owners and Breeders subsidize the racing product heavily and that their contribution is, at least, equal to the contribution made by punters.

It is central to the prosperity of the ARI that returns to Owners are not diminished in the drive for competition between wagering operators, lest this result in a stunting of the ARI, reduction in its revenue and lower returns to Government.

We support the submission of Racing NSW to the extent that it recognizes the plight of the majority of Owners in Australia who, in most cases, receive a very modest return for their contribution. With respect, the Tabcorp representatives formulated the correct questions (at Transcript 10.6 on 26th November) as “***how do we distribute wagering returns to owners and what is the right configuration of that?***”

Without financial encouragement for owners, breeders, trainers and other participants there is no industry.

F. The Community Interest

Another major impediment to the finalization of the Draft Report in its present form lies in its failure to identify, with any precision or accuracy, the “consumers” whose interests the report suggest, should be maximized. It is said that:

“the interests of consumers, and thereby the racing industry, are likely to be best served by a diverse and competitive wagering market”.

But who are the consumers for whose “benefit” the Draft Report suggests the industry ultimately exists (13.13)? The issue is dealt with at chapter 1.3 of the NHRA Report.

There seems to be an underlying assumption throughout Chapter 13 than any enhancement in the number of corporate bookmakers and their patronage will benefit consumers generally (eg at 13.10.3 and 13.13.2).

The Draft Report appears to contain little or no analysis in support of that premise. We are not aware of any survey undertaken to determine what proportion of punters have (or are likely to have) any interest in betting with corporate bookmakers or for that matter any agency other than their local TAB, Pub TAB or Club TAB.

It is certainly true that some punters prefer better odds but it is by no means clear that the vast majority of punters have any particular interest in obtaining the advantage thought to be offered by corporate bookmakers in terms of odds. Perhaps this can be best illustrated by the fact that – as anyone who attends race meetings will know – many punters will bet with the tote rather than with bookmakers (although the odds to be paid are then unknown) and many will place a bet with a particular bookmaker rather than search for one who may offer one or two point longer odds.

The Commission states that ***“the fundamental question when analyzing any change in the racing industry funding model (is): will it result in better outcomes for consumers”*** (13.24).

However, it is not reasonable or practicable, other than in a most general way, to approach the ARI merely from the prospective of those who wager on its events.

In this regard, we attach a summary of Sky/TVN ratings for an eight week period commencing 18 October 2009. During this period, Sky and TVN had an average weekly audience of more than 900,000 daytime viewers, in a period when Saturday meetings were also being broadcast on free to air TV.

All these people are members of the racing community, whose financial and broader interests may be impacted by the Commission’s recommendations.

G. Product Fees

The quantum of product fees and the manner in which they should be determined has generated much debate.

The Commission's apparent preference for a gross revenue basis is quite speculative - eg "**alleged potential**", "**not clear**", "**may enable**" (all at 13.28) and "**more likely to**" (13.31). All these observations are hypothetical. Neither the ARI nor its participants should be put at risk by adoption of the recommendations which this speculation supports.

There is a need for certainty in the ARI's funding model. The NHRA opposes a fee based on gross profit and it does so, in part at least, because of this need for certainty.

We should add that we do not see why product fees should be limited to race fields. There is a range of components (such as racing colours, race conditions, handicapping, names and prizemoney) which together produce a product properly the subject of copyright and which should be charged for.

The opinions expressed in Chapter 13 have no empirical support. The effect of a gross revenue model would be to make the ARI dependent upon the particular business regimen undertaken by a particular wagering operator or upon specific business decisions, be they wise or unwise, considered or ad hoc. This is well illustrated on page 37 of our report.

Moreover, this model has already been tested and failed, with unfortunate outcomes for racing (Chapter 3 of NHRA Report). In short, wagering operators should pay a proper fee for their access to the racing product, such as will support the industry on which they operate.

We observe that the Draft Report appears to accept and acknowledge:

1. The cultural significance to many Australians of the racing codes (eg at 13.2).
2. The need for adequate compensation of the ARI for wagering on its product (13.2).
3. The importance to the viability of the ARI of the contribution to its funding by wagering operators (eg 13.1).

We hope that the points we have made underscore the difficulty of reporting on a major industry as a tangential aspect to an Inquiry into another industry - gambling.

H. Conclusions

In our submission, the assumptions which have lead to the findings and recommendations in chapter 13 all jeopardize the integrity of this chapter of the Draft Report.

1. The ARI is a major contributor to the Australian economy and a quintessential part of Australian life. Under no circumstances should its continued prosperity be made dependent upon the business acumen, integrity and largesse of corporate bookmakers.
2. The UK model, which Chapter 13 appears to advocate, has failed to deliver expected or satisfactory outcomes.
3. The Commission has misunderstood the relative financial contribution of owners, breeders, punters and others to the Australian racing product.
4. The Draft Report fails to evaluate the social and economic consequences of a downsizing of the ARI, including unemployment and a less appealing product upon which to wager. Widespread unemployment is inevitable, particularly in rural communities, if the Draft Report is adopted. Its findings and recommendations put at risk the Australian Racing industry, taxation revenue and the means by which problem gambling may be controlled.
5. The Draft Report fails to take account of the community interest of participants and the wider general public. The “community interest” is not necessarily to be equated with or to be a function of, or derived from, those punters who bet with corporate bookmakers.

The result is that the premises upon which Chapter 13 founds are misplaced.

We strongly recommend adoption by the Commission of the Recommendations set out at chapter 5 of the NHRA Report.

Yours sincerely

Michael Sissian
Co-Convenor NHRA

Industry Response to Productivity Commission Report on Gambling

The National Horse Racing Alliance (NHRA)

December 2009

EXECUTIVE SUMMARY

Racing has moved into a new competitive arena through developments in information technology. These developments have allowed new wagering operators to shape the industry's future by disrupting traditional wagering flows and regulated geographical boundaries. These changes are not reversible; in fact, they must be embraced and accommodated. However, this will only be possible with mechanisms in place to prevent 'free riding' – wagerers who place bets on the outcome of races without having to make any payment to the racing industry. 'Free riding' poses a risk to the longer-term viability of the racing industry and the broad base of producers and consumers that contribute to and enjoy its benefits.

In its Draft report on Gambling, the Productivity Commission has recognised these challenges and has proposed recommendations to both shape the future playing field and the basis of competition within the wagering sector. Given the strong interdependence of the wagering sector with the racing industry, these recommendations will directly influence the size, shape and health of the Australian Racing Industry as a whole, as this submission will illustrate. The package suggested by the Productivity Commission appears to be based on applying the UK model. Unfortunately, that UK model has not succeeded as planned. Therefore, applying the same approach in Australia is certain to see a significant decline in the size of the industry due to a reduction in participation.

Accordingly, this submission makes a strong case for a revised approach that:

- Recognises the starting strength of the Australian industry and its broad consumer base who contribute significantly to the Australian economy
- Reinforces the important role of pari-mutuel wagering returns and the TABs that deliver them
- Draws on the key lessons from offshore markets, especially the UK, in defining the nature of the levy and the means of determining it
- Highlights areas to reinforce integrity and problem gambling initiatives, and
- Restricts and discourages offshore and other illegal operators.

Accordingly, NHRA recommends the following actions to deliver dynamic and enduring racing and wagering industries in Australia:

- Ensuring the continuation of a strong pari-mutuel wagering base thereby including
 - Higher levy rates for pari-mutuel wagering
 - Retail exclusivity for TABs
 - Banning or imposing an additional product fee for tote-odds betting
 - Measures to limit offshore wagering or to levy it effectively

- The right of the industry to develop, promote and price its product
- A strong preference for a percent of turnover levy to provide an enduring outcome
- Further strengthening of integrity disciplines
- Additional controls to limit the risk of problem gambling.

In addition, NHRA supports the direction of the Productivity Commission recommendations with respect to:

- The need to prevent 'free riding'
- A harmonised, national taxation agreement
- Consistent, national rules for credit betting, incentive inducements and advertising.

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1. THE NEED TO ENHANCE, NOT DRAMATICALLY DOWNSIZE, THE AUSTRALIAN RACING INDUSTRY

The purpose of this chapter is to emphasise the scope and contribution of the Racing Industry, its international competitiveness and the diversity of producers who contribute to, participate, watch and wager on the sport of thoroughbred racing. Within this context we have identified the ‘price sensitive’ wagering consumer who represents a small proportion of the total customers that the industry serves, yet whose needs appear to drive many of the recommendations in the Productivity Commission’s draft report.

1.1 Scope and contribution of the Australian Thoroughbred Racing Industry

The impact of the Australian Racing Industry is significant. The size and scope of the Australian Thoroughbred Racing Industry (ATRI) has been presented in many documents including the submission to the Productivity Commission by the Australian Racing Board¹, The Boston Consulting Group’s review attached to Racing NSW’s submission to the Cameron Enquiry² and the original IER review in 2007³.

Australian thoroughbred racing is a sizeable employer, especially in the non-metropolitan areas, and generates demand for a wide range of goods and services. The number of people who participate in delivering thoroughbred racing, race day attendance and wagering activity is an important part of the nation’s social fabric.

For the purposes of this report, we have defined the economic core of the ATRI as comprising three integrated parts:

1. The production of thoroughbred horses – this includes horse breeding, bloodstock sales, horse ownership, and the training and upkeep of horses.
2. Racing – which entails the holding of race meetings and includes racing administration, race clubs and jockeys.
3. Wagering – which involves operators such as bookmakers or Tabcorp, who accept wagers on races.

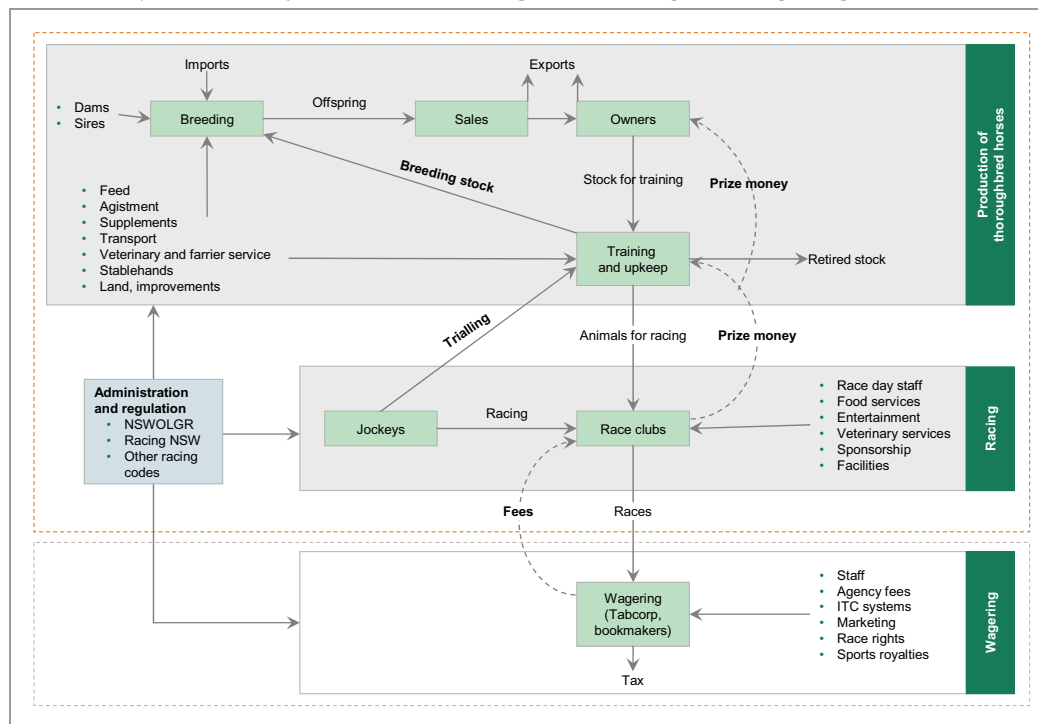
¹ Australian Racing Board, Gambling Productivity Enquiry Submission 2009

² BCG, Report to Racing NSW, July 2008

³ IER; Economic Impact of Australian Racing, 2007

The industry also includes functions for administration and regulation. These are an integrated set of activities that have evolved together with the strongest links being between horse breeding, training and racing. Exhibit 1 illustrates an overview of the industry and the interrelationships between its key elements.

Exhibit 1: Industry overview of Australian thoroughbred racing and wagering



Note: Adapted from Australian Racing Board. 2003. Submission to the Review of Issues Related to Commonwealth Interactive Gambling Regulation.

Our definition of the Racing Industry fits with that used by most studies of the economic impact of horse racing, such as:

- The 1992 ACIL study of the Australian racing industry¹
- The 2001 RIRDC study of the Australian horse industry²
- A 2002 assessment of the Kentucky equine industry³
- Indecon’s 2004 study of the Irish breeding and horse racing industry⁴
- Deloitte’s 2009 assessment of the economic impact of British racing⁵

The inclusion of breeding and wagering reflects that their fortunes are closely tied to training and racing, and vice versa. Most horses race in the region where they are trained, except highly rated

¹ The Contribution of the Racing Industry to the Economy of Australia, ACIL, 1992

² The Horse Industry: Contributing to the Australian Economy, RIRDC Publication 01/083 Gordon, J. 2001

³ The 2002 Economic and Fiscal Impact of the Kentucky Equine Industry, CBER, University of Kentucky, 2004

⁴ An Assessment of the Economic Contribution of the Thoroughbred Breeding and Horse Racing Industry in Ireland, Indecon, 2004

⁵ Economic Impact of British Racing, Deloitte, 2009

animals, which that are routinely transported to the major metropolitan meetings. The hierarchy of race meetings provides the opportunity for developing and proving a horse’s performance within or across states.

Through an economic lens, the most recent and complete assessment of the ATRI was undertaken by IER¹ and covers the 2005-06 years as outlined below.

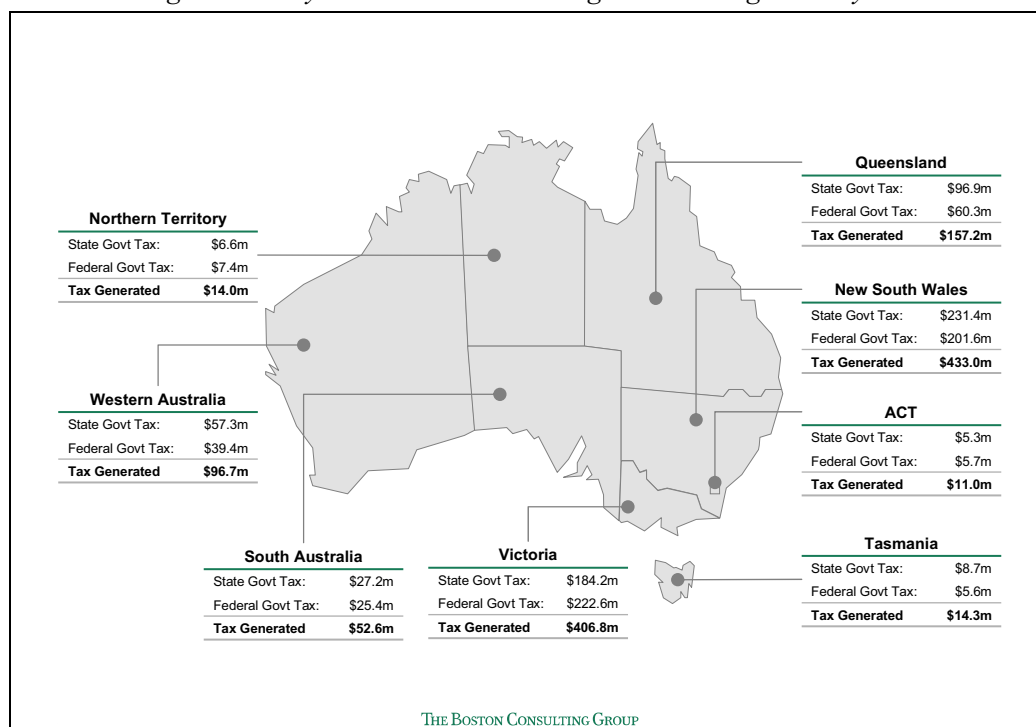
Table 1: Economic impact of Australian thoroughbred racing: 2005-06

	Australia
Real gross value added	\$5,042m
Real consumption	\$2,434m
International exports	\$775m
International imports	\$1,104m
Thoroughbred share of GDP	0.53%

Source: IER, op. cit. Note: Gross Domestic Product shares recalculated using ABS data for denominator.

Finally, it is important to restate the current taxation arrangements, which are directly linked to the size of the industry and the current arrangements within it. IER found that the ATRI generated \$1.2 billion in combined state and federal taxes each year. Taxes on wagering comprised almost half of this amount, with GST the next largest component.

Exhibit 2: Taxation generated by the Australian Thoroughbred Racing Industry



¹ IER, Economic Impact of Australian Racing, 2007

In summary, the scope of the racing industry’s direct participation in the economy is broad and heavily biased to the rural community, in particular:

- In NSW for example, in 2008/09 there were an estimated 7,030 horses in training at any one time and of these 5,480 or 78% were trained outside the metropolitan area. Further, of the 1,130 trainers licensed in NSW for 2009/10, 1,026 trainers or 91% were located in provincial or country areas
- The majority of country towns who hold annual cup meetings where the community comes together with horses, jockeys, trainers and city dwellers
- The farms that breed and raise bloodstock for market and the people employed there or who provide services including veterinarians, farriers, etc.

The Productivity Commission Draft Report makes no attempt to identify and evaluate these broad community interests: jobs, investment, government revenue, welfare and social cohesion/harmony. These points are all secondary to the report’s main concern, which is lower gambling margins and better prices for the punter.

The report also makes no further mention of the 230,000¹ part or full-time participants in the industry, or that the majority of these people are untrained, live in rural communities and lead productive lives. However, this fact alone distinguishes racing from every other aspect of gambling. In racing, horses (and dogs) are very labour intensive, which means that this industry generates far more employment than other forms of gambling (aside from casinos). Most other forms of gambling are digital, and therefore offer only minimal employment opportunities.

1.2 Global Competitiveness of the Australian Thoroughbred Racing Industry

Australia has arguably the strongest racing industry in the world on a per capita basis. Even in aggregate terms the ATRI ranks in the top three racing industries in the world on all industry indicators, notwithstanding its much smaller population and economy compared to counterparts such as the US, Japan, Great Britain and France.

Table 2: Australian thoroughbred racing on a world stage

Rank	Stats	Black type races	Prize money	Foals born
1	USA	USA	USA	USA
2	Japan	Australia	Japan	Australia
3	Australia	Great Britain	Australia	Ireland
4	Great Britain	France	France	Japan
5	France	Argentina	Great Britain	Argentina
6	Chile	Japan	Korea	Great Britain
7	Argentina	South Africa	Turkey	France
8	Italy	Brazil	Hong Kong	New Zealand
9	South Africa	New Zealand	Ireland	Brazil
10	New Zealand	Ireland	Italy	Canada

Source: ARB Australian Racing Fact Book

¹ Refer to IER; Economic Impact of Australian Racing 2007 for the breakdown of estimated industry participants

This position has resulted from the industry building valuable capabilities in horse breeding, training and in race wagering, and in the technical delivery of these capabilities. The Racing Industry is large enough to be able to support the development of specialist skills, and its long history has allowed substantial experience to accumulate. A cluster of activities around thoroughbred breeding and training has grown up within the major racing states.

The importance of this competitiveness and capability increases when future Asian growth opportunities are considered. Asian thoroughbred racing is going from strength to strength and the Australian industry is well positioned to serve them through

- The export and import of wagering product potentially leading to co-mingled wagering pools
- Horse exports which increased by 50-100% plus over the last five years
- Taking advantage of strong growth in the Singapore and Hong Kong industries
- Transferring skills and expertise in training and veterinary services for example.

In addition, China is an emerging market with no official racing system yet. The large increase in exports in recent years reflects the impending decision to permit racing by the Chinese authorities.

The Productivity Commission report discusses a number of 'inefficiencies' in the Australian Racing Industry. Data is presented on races per track, total turnover and turnover per race. Like all industries, organisations or firms within an industry, there is room for improvement; the Racing Industry recognises that it needs to continually improve and innovate. However, the relative position of the industry and the potential for improvement needs to be realistically understood. In particular:

- Track use comparisons need to be done on an 'apples for apples' basis. Dirt or synthetic tracks are not comparable with turf; and regulated industries exist, such as those in Hong Kong and Japan that limit the industry size and footprint, and thereby drive higher asset use
- There have been multiple reviews undertaken in NSW, Victoria, Western Australia, Queensland and New Zealand of the racing product's cost of delivery and the possibilities of merger between race clubs. The conclusions of these reviews have been that although many tracks, mainly those in the country, are used infrequently, they become a communal focus for their cup, carnival and picnic meetings. These facilities are seldom owned, often shared or leased from Councils or local Agricultural Societies and the like, and use voluntary labour and community contributions to operate.
- Recent examples exist in all major racing states of further efficiency measures such as club mergers and new facilities planning.

This pattern of efficiency improvement is historical, but shapes the very fabric of racing in Australia. Racing is a broad inclusive activity which is easily available to those who want to participate. The continuation of these outcomes is highly dependent on the forces and arrangements that will shape the future of Australian Racing.

1.3 The broad consumer base versus the ‘price sensitive’ consumer

The Commission has heavily emphasised the need for primary attention to consumer needs, without identifying either the consumers or their needs. Who are the consumers for whose “benefit” the Draft Report says the racing industry ultimately exists?

There seems to be an underlying assumption in the Draft Report that any enhancement in the number of current corporate bookmakers and their patronage will benefit consumers generally, yet there is little or no analysis to support that assumption.

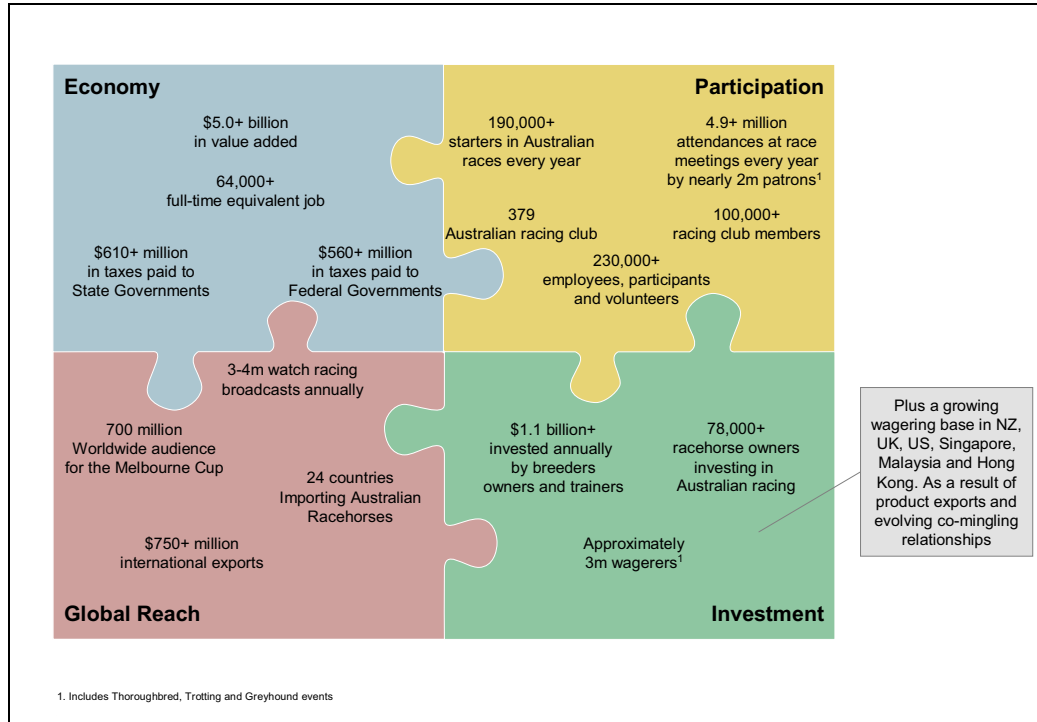
It is not reasonable or practicable, other than in a most general way, to discuss the racing industry merely from the perspective of those who wager on its events. To do so ignores:

- The cultural role of the industry as part of the fabric of the Australian make up and ethos
- Those who attend race meetings or follow racing not as serious punters but as owners, observers, hobbyists or just for the occasion
- The cost of putting on the show, including integrity measures which are essential to a healthy industry and to the confidence of punters, bookmakers and the wider racing community (stewards, drug testing laboratories, etc)

All these people are members of the racing community, who financial and broader interests may be adversely impacted by the Commissions recommendations.

As highlighted in the previously referenced ARB submission to the Productivity Commission, consumer involvement in racing extends considerably beyond the core economic activity and includes participation of both the broader wagering population and race meeting attendees. A snapshot of the size and scope of the ATRI is illustrated in Exhibit 3.

Exhibit 3: An overview of the Australian Thoroughbred Racing Industry



Firstly, this snapshot indicates the magnitude of racing’s total consumer base and their broader economic impact. In particular:

- Nearly two million people attend race meetings each year for a total of 4.9m annual attendances¹
- On average three million people (one-fifth of the Australian adult population) wager on thoroughbred, horses and greyhound racing each year
- Approximately twice that number, three to four million people, watch racing broadcasts during the year
- More than 700 million people worldwide watch the Melbourne Cup annually.

Secondly, it is interesting to disaggregate the wagering population. Much of the Productivity Commission’s focus is upon the need to give the larger, more professional wagerers better odds. However, consumer research indicates that this segment is limited. Indicative estimates indicate it is a small proportion of the total wagering population, and that the remaining larger segments have a different motivation and expectation from their wagering, racing experience. For example:

¹ Australian Government Publication 4,156.0, Sports and Physical Recreation – A Statistical Overview, 2009

- State wagering reviews suggest:
 - For NSW¹ 20% of adult population wagers on racing annually
 - For Queensland² 16% of adult population wagers
- In discussions, wagering authorities in Australia and New Zealand provided an estimate that 2-4% of the wagering population fall into the ‘high price sensitive’ category, today or in the medium-term
- The vast majority of the wagering segment is typically assigned segment classifications as ‘regulars’, ‘carefrees’ or ‘socials’. These account for the 90% of customers that typically use the TAB networks³

If we take the range suggested of the total population of adults that currently, or could in the medium term pursue channels that provide lower take out, then this consumer group in Australia represents on average a small proportion of those who wager or some way participate in racing.

1.4 Summary

In summary, this snapshot of the industry reveals:

- A significant economic contribution
 - 230,000 plus people involved; many in rural areas
 - \$1.1 billion plus invested annually by breeders, owners and trainers
 - \$5 billion plus real gross value-added
 - \$1.2 billion plus in taxes paid.
- A globally competitive industry with future growth prospects
 - The ATRI ranks in the top three racing industries in the world on all industry indicators
 - Critical mass and specialist skills have allowed substantial experience to accumulate and build the industry position

¹ AC Nielsen, NSW Office of Liquor, Gaming and Racing, Prevalence of Gambling and Problem Gambling in NSW, A Community Survey 2006, March 2007

² Queensland Household Gambling survey 2006-07

³ RIGC submissions to Productivity Council, December 2009

- Inefficiencies cited in the Commission’s report exist, but are being constantly evaluated and addressed
- The current and future opportunities in Asia are another reason to build a strong and enduring Racing Industry.
- A broad consumer base that participates in the Racing Industry
 - Nearly two million adults attend race meetings annually and yield 4.9 million+ attendees
 - An average three million people wager on racing annually; more than that number watch racing broadcasts each year
 - Globally, the product reaches Asia, US, UK and New Zealand, with over 700m people viewing the Melbourne Cup. Racing is a defining feature of Australia.
- A smaller ‘price sensitive’ consumer exists
 - Approximately, 20% of Australians wager on animals annually; approximately, 2-4% of this segment wager once a week or more which potentially includes the price sensitive segment
 - Accordingly, approximately 0.5-1% of the total adult population are likely to be, or could be in the medium term, price sensitive wagerers
 - 90% of customers that wager through the TAB are “social” wagerers

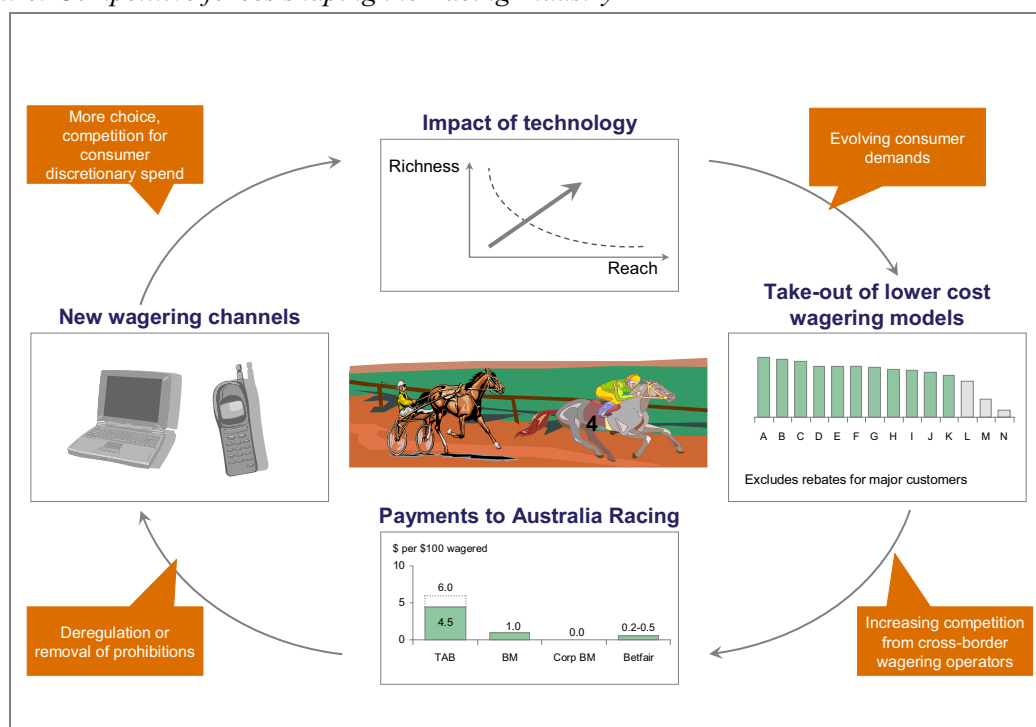
The Australian Thoroughbred Racing Industry generates a substantial degree of employment, extensive taxation benefits and a degree of social cohesion which makes it out as different from other gaming industries. The consumer base is large, broad and diverse along many dimensions. Within the wagering segment, the current and potential ‘odds sensitive’ segment is small relative to the broad participant base. Therefore, any recommendation that affects this industry must balance the needs of all its stakeholders in the industry and neither substantially penalise or favour any one consumer segment over another.

Accordingly, NHRA submit that part of Chapter 13 in the Draft report that contemplates the downsizing of the industry is not founded on sound analytical techniques. Instead it relies upon generalisation and statements of participants who are no doubt entitled to their opinion but do not represent anything like a broad or community perspective.

2. THE IMPORTANCE OF WAGERING IN SHAPING THE FUTURE OF AUSTRALIAN RACING INDUSTRY

While there are many sources of funding of the Australian Racing Industry, income from wagering and contribution by owners are the most significant. However, over the last 10-15 years, the business of producing racing has undergone profound change. As with many other business, that change is the direct result of developments in information technology, causing the breakdown of traditional wagering funding arrangements (Exhibit 4).

Exhibit 4: Competitive forces shaping the Racing Industry



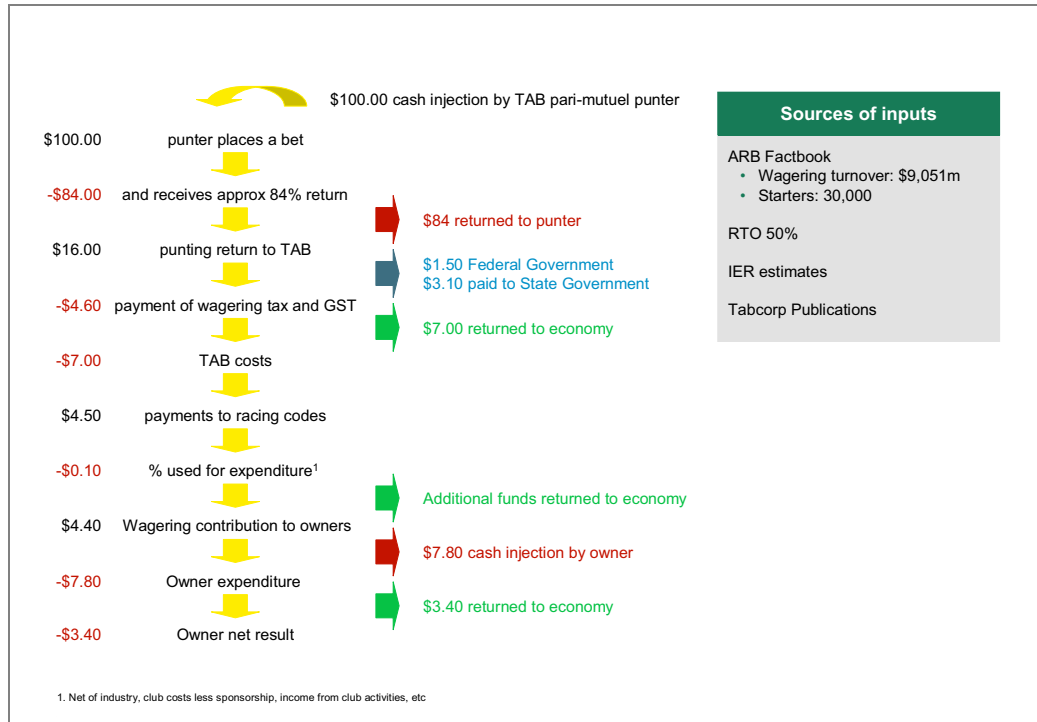
Source: Chang B, Jackson A Wagering Product Pricing and Elasticity; 32nd Asian Racing Conference, Japan, November 2008

It is very clear that wagering income both directly and indirectly is an important driver of the size, shape and structure of the industry. This section clearly portrays those relationships for the Australian Racing Industry and describes how they may evolve under different arrangements in the future.

2.1 Sources of funding of the Racing Industry

The diagram below illustrates ‘where the money goes and who provides it’. As the diagram shows, payment to the racing codes that flows on to the racing clubs is not sufficient to cover the owners’ racing expenses.

Exhibit 5: Estimated sources and uses of funds in The Australian Thoroughbred Racing Industry 07/08



Source: IER 2007; ARB Factbook 2007/08; Cameron Review Submissions

The above calculation utilises a return to owners of 50%¹ to calculate the cost to owners and compare with the contribution from wagering. Wagering with bookmakers is excluded as it is currently a very low, or at times zero, contributor to staging the racing product.

Another way of approaching the calculation is with that alluded to in the IER 2007 report. This is outlined below and uses the following input for the 07/08 year.

Inputs

- Number of horses training = 30,000 × 1.2 to allow for horses who did not start
- Cost of training horses = \$20,000/year on average
- Prize money paid to owners (as per ARB Factbook) = \$355m + \$35m (net other payments¹)
- Payment to trainers/jockeys by owners = 15% × \$355m
- TAB wagering turnover = \$9,051m

Calculation	\$m	\$/ \$100 wagered
Costs to owners 30,000 × 1.2 × \$20,000	(720)	\$(7.95)
Less prize money	355	} \$3.72
Less net other payments	35	
Plus payments to jockeys	(53)	
Net input by owners	\$383m	\$(4.23)

1. Other returns to owners include starters rebates, appearance fees, float rebates, fees paid on behalf of owners, etc less nominations, acceptance, etc; Estimated bonus scheme income and fees have been excluded

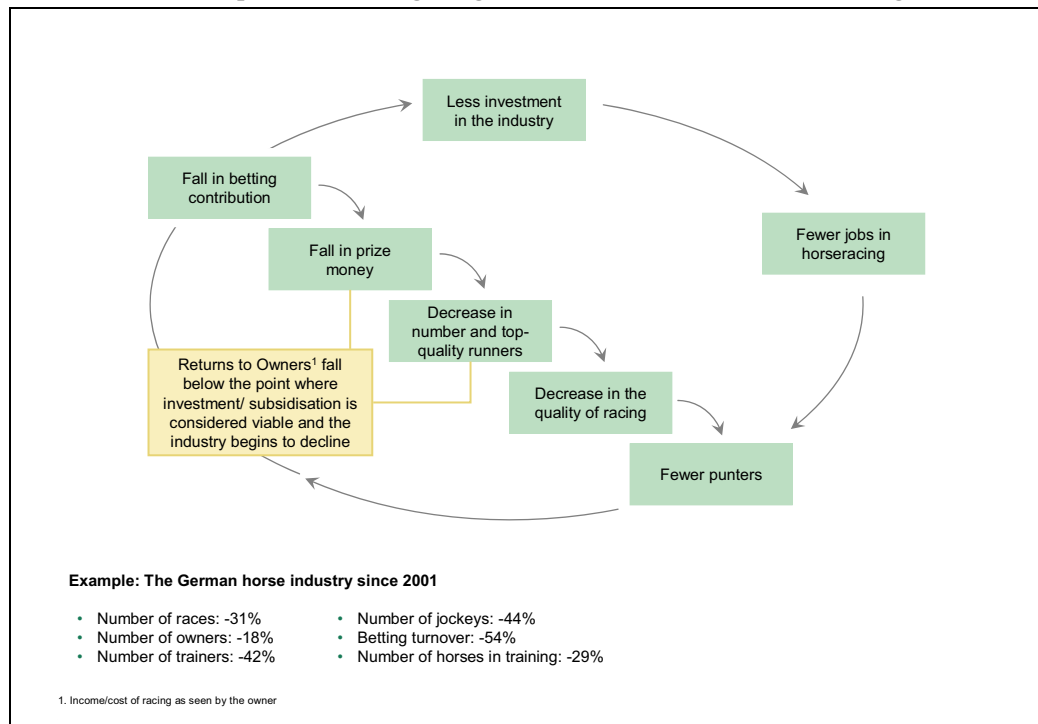
¹ Racing Victoria Annual Report 2003

Both analysis of the dollar flows shows that the industry requires cash injections from external sources in order to continue operation. In summary, the analysis reveals per \$100 wagered through the TAB:

- Net cash contribution by punter \$16.00
- Net racing contribution by punter to owners \$4.40 → \$400m
- Net racing contribution by owner \$3.40-4.20 → \$310-380m
- Funds paid to government \$4.60
- Funds returned to economy \$10.40 plus.

Of particular importance in shaping the racing industry is the relationship between owners' contribution and funding from wagering in the industry (Exhibit 6).

Exhibit 6: Interrelationships between wagering and owners' contribution to racing

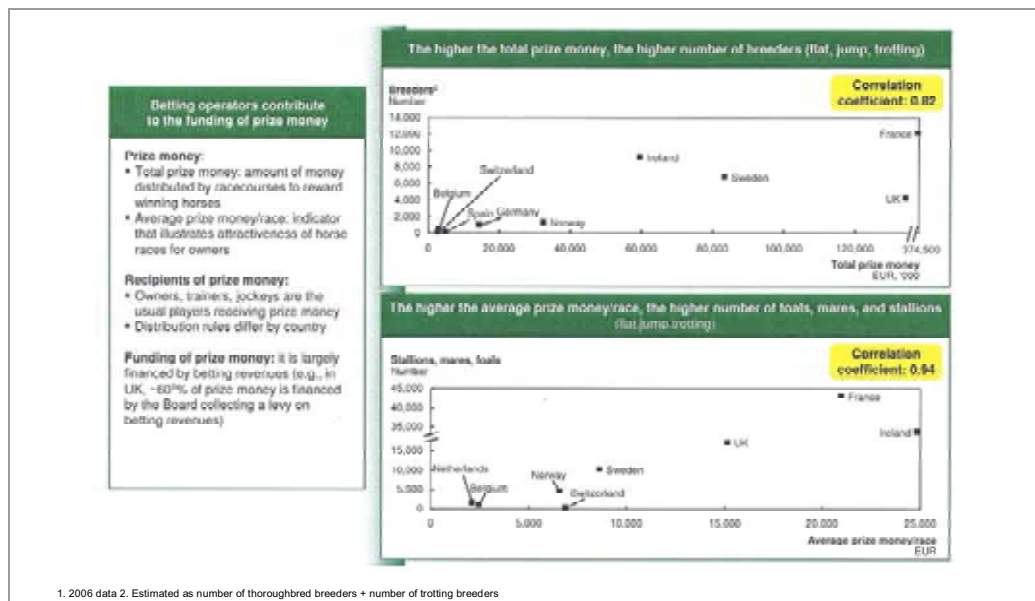


Source: EPMA, *Economic and Social Contribution of Horseracing in Europe*, 29 October 2009

Unfortunately, the relationships illustrated above are highlighted in the EPMA report and have been observed in Europe and the US; if the wagering contribution declines, the industry begins on a downward spiral. This phenomenon is discussed further in the following section.

In addition, the impact of the wagering relationship extends beyond the racetrack, as illustrated in Exhibit 7.

Exhibit 7: Determinants of the performance of the horse



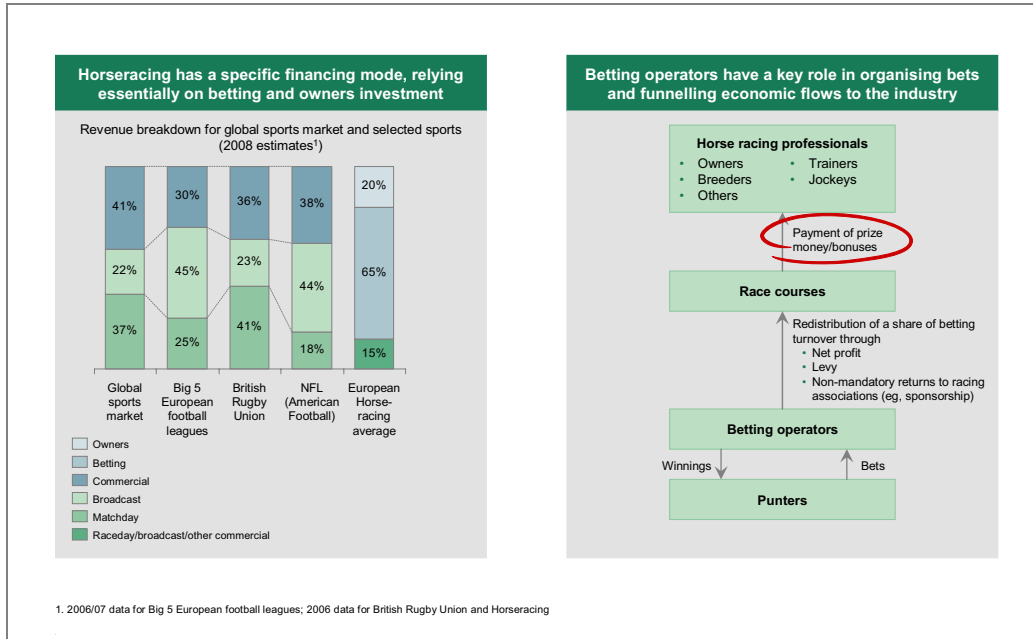
Source: EPMA, *Economic and Social Contribution of Horseracing in Europe*, 29 October 2009

Accordingly, without adequate wagering inflows and the encouragement of owners, breeders, trainers, jockeys and other participants, there is no industry.

2.2. The impact of wagering in shaping the future of the industry

Among different sports bodies, racing is unique in its dependence on the contribution from wagering (Exhibit 8) even though this contribution may be less than the contribution of owners (see Exhibits 5 and 6) and other industry participants, eg. breeders as orally outlined to the Commission by Martin Enfield QC on 15 December 2009.

Exhibit 8: Sources of funding across different sports



Source: EPMA, *Economic and Social Contribution of horseracing in Europe*, 29 October 2009

As Exhibit 5 reveals, the same relationship exists in Australia. Most importantly, and within the total wagering contribution, the relative contribution from the TAB (primarily ‘pari-mutuel operators’) is disproportionately high. There is clear evidence that pari-mutuel operators’ direct contribution to horseracing funding is higher than their relative market share, based on turnover.

- The October 2009 EMPA report on European Horseracing estimates pari-mutuel operators account for 43% of the turnover versus 84% of the direct betting contribution to horseracing funding
- The British Horse Racing Association estimates that the largest online exchange in the UK now accounts for 21% share of net winnings by all race wagerers (internet and retail) compared to less than one-third of the total levy fund contribution in 2008/09.

In addition, the experience worldwide is that where wagering is mainly or solely through the totalisators, returns to owners are higher and racing is stronger (Table 3).

Table 3: Wagering arrangements versus returns to owners

Returns to Owners	Wagering Model	
100%+	Hong Kong	Totalisator Only
	Singapore	Totalisator Only
60-100%	Japan	Totalisator Only
45-60%	France	Totalisator Only
	USA	Totalisator Only
	Australia	Primarily Totalisator
	South Africa	Primarily Totalisator
<30%	Ireland	Primarily Bookmaker
	Germany	Primarily Bookmaker
	Britain	Primarily Bookmaker

Source: Racing NSW CEO Presentation to 32nd Asian Racing Conference, Tokyo 2008

This is also evidenced in Australia as TABCORP presented in their submission to the Productivity Commission¹

Table 4: Racing industry funding by operator FY08

Operator	\$m to Victorian racing industry	\$m to NSW racing industry
TAB		
• Wagering	226	212
• Gaming	74	-
Local bookmakers	5*	7*
NT corporate bookmakers	5**	0
Betting exchanges	0	0

Source: TABCORP, Submission to the Productivity Commission's Inquiry into Gambling, April 2009

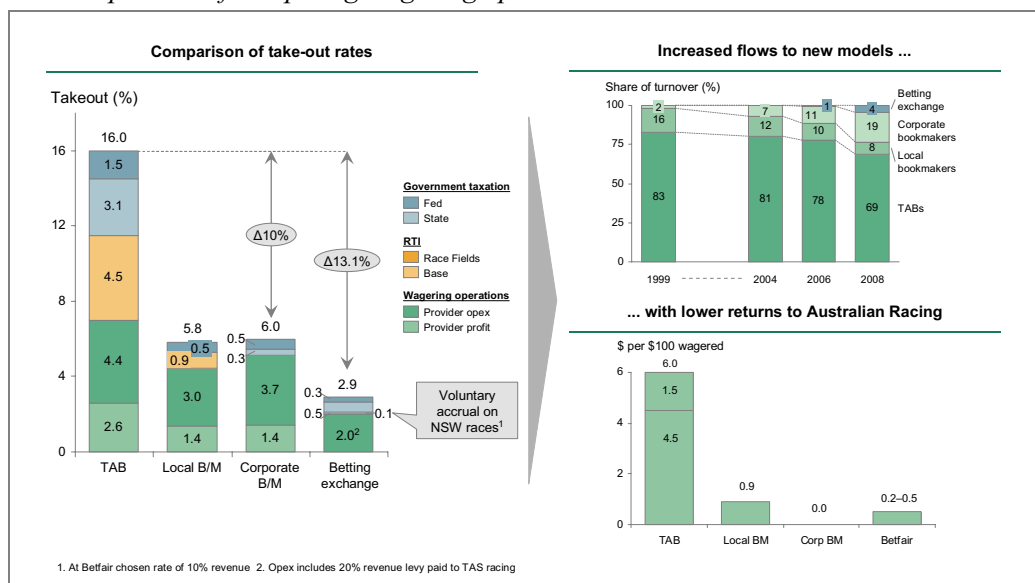
In short, wagering operators should pay an adequate fee for their access to the racing product, such as will support the industry on which they prosper.

¹ Tabcorp, Call for a national approach to the regulation of the Australian Wagering Industry, Productivity Commission Submission, April 2009

2.3 Projection of future industry funding under different scenarios

In Australia today, competition for the wagering dollar is between four parties — TABs, local bookmakers, corporate bookmakers and betting exchanges. The business models and the contributors and the turnovers are illustrated in Exhibit 9 below.

Exhibit 9: Comparison of competing wagering operators in Australia



Source: Annual Reports; Interstate Comparison of Taxes 2007-2008; Press releases; Australian Racing Fact Book 2008; RNSW; BCG Cameron Report submission

In reviewing wagering trends, the Productivity Commission concludes, ‘free riding’ behaviour will cause a decline in the contribution of wagering to funding the industry. This has already commenced with a real decline of 4.6% per annum between 2005 and 2008 and has flow on effects, for example

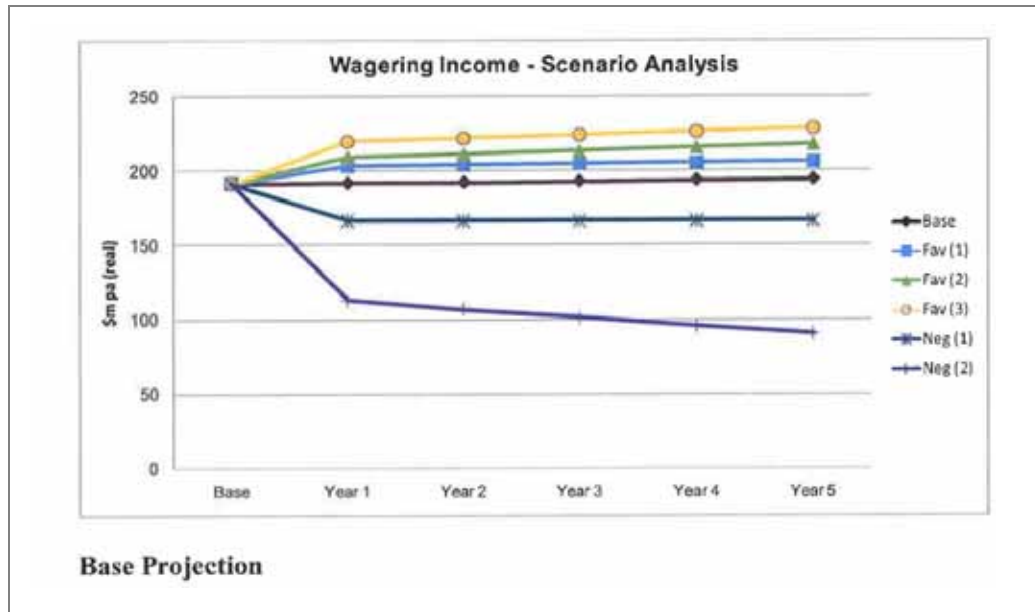
“Trainers across Australia continue to be under severe financial pressure to remain in the industry. The great majority of trainers do not earn any income from the training fees charged to owners but rely on prize money percentages and other activities to survive. In NSW in 2008/09, of the 1,192 trainers licensed in NSW only 20 trainers or 1.7% earned prize money income of more than \$100,000.”

Source: Industry Factbook; Industry interviews

Taking a longer timeframe between 1999 and 2009, and using thoroughbred racing in NSW as an example, Exhibit 10 illustrates a significant real decline to industry revenues, even allowing for an estimated contribution from the corporate bookmakers and the betting exchanges.

Looking forward, work has been undertaken by RVL¹ in predicting future racing inflows under different scenarios (Exhibit 10).

Exhibit 10: Predicted wagering income – RVL scenarios



Both this work and the previous BCG² work, which has extended to considering all effects together going forward, reached the same conclusions, namely:

- Industry returns will continue to decline unless the corporate bookmakers and exchanges pay an adequate fee for access to the racing product
- A levy or product payment is the only basis of halting the decline
- There is an immediate uplift in contribution of wagering to the racing industry as the ‘free riding’ activity is eliminated under either the proposed RVL or RNSW proposes
- The change to a single ‘UK level levy’ accompanied by the removal of retail exclusivity results in a dramatic decline in industry revenues.

These conclusions are based upon extrapolating channel growth rates through changing consumer preferences, but the continuation of today’s business models. As will be illustrated in the next section, these assumptions may not stand the test of time and accordingly the projections are likely to represent a ‘best case’ for the industry which may not eventuate.

¹ RVL analysis presented in the ARB Productivity Commission Submission on Gambling, 2009

² Discussions with BCG on the Cameron Report Submission

2.4 Summary

There are some very clear conclusions from this chapter. In particular:

- Owners and wagerers shape the Racing Industry
 - Owners and wagerers are the principal contributors to the Racing Industry. The net contribution to racing is
 - Owners : \$310-380m
 - Wagerers : \$400m
- Their fortunes are interlinked: if the wagering contribution starts to decline, owners reach a point where the likely return is too low and the current broad participation in a strong industry begins to unwind. The outcome is likely to be smaller fields of poorer quality and, as a consequence, falling wagering revenue. The integrity of the product will also come under pressure, given the high cost of integrity measures
- The contribution of wagering, particularly pari-mutuel wagering is critical and determines the difference in the size and shape of the racing industry
 - Racing, like many industries is facing many challenges
 - Unlike many other sporting bodies, wagering is key to horseracing funding
 - Contribution to wagering shapes all aspects of the industry; the European examples provides evidence for both racing and breeding sectors
 - Australia is a clear example of the importance of funding from pari-mutuel wagering.

Accordingly, only a contribution from all operators and a strong pari-mutuel channel will deliver a strong and enduring industry of similar size and scope as it is today.

3. EVIDENCE BASED IMPERATIVES TO STRENGTHEN THE AUSTRALIAN RACING INDUSTRY

In its description of The Policy Framework (3.2) the Commission emphasises:

‘A key requirement for all of the above features of good policymaking is the appropriate use of evidence – broadly interpreted as in Figure 3.1 – to justify policy makers’ decisions’.

As outlined in the previous chapter, international evidence clearly indicates the overall shape of the racing industry is determined by a number of factors, at the core of which is the contribution from wagering. The Productivity Commission is very clear in reaching the same conclusion in the first ‘key point’ in the summary to Chapter 13, ie

Key points

- *Without mechanisms to prevent ‘free-riding’, people could take bets on the outcome of races without having to make any payment to the racing industry. This poses a risk to the longer-run viability of the racing industry and would have detrimental consequences for the communities where racing plays a key role. More importantly, such a decline would also adversely affect consumers of wagering and racing products.*

However, opinions differ on the draft recommendations presented by the Productivity Commission. Our submission is based on global evidence on how to achieve long-run viability of the racing industry. The two pertinent pieces of empirical evidence presented in this section are from the European operators in grappling with similar issues and the ten years plus experience in the UK from changing levy regimes.

These global lessons and the implications for the Australian Racing Industry are reviewed and summarised under the following headings.

- 3.1 Lessons from the European Racing Industry
- 3.2 Lessons from the UK experience
- 3.3 Similarities with the online music industry
- 3.4 Implications for the Australian Racing Industry

The primary objective is to deliver a strong and enduring Racing Industry. This industry vision embraces continuing innovation and advancement of the industry and delivers on needs of the differing segments of the broad base of consumers who participate in this industry. It will be shown that the ‘UK model’ is not an outcome for which the Australian Racing Industry should aspire.

3.1 Lessons from the European Racing Industry

Australia's issues are not isolated. Other racing jurisdictions are experiencing the damage inflicted by 'free rider' wagering operators.

'The case of Germany illustrates the weakness of the system. Due to a legal framework requiring no contribution from bookmakers to the horseracing sector and the development of a financially attractive offshore-based offer, the German horse industry is insufficiently financed through betting. As a result, it has been strongly in decline since 1995

- *The number of German races has dropped by 44%*
- *The number of owners has dropped by 40%*
- *The number of mares has been reduced by 22% and breeding has been reduced by 30%.*

*It took centuries to build the racing industry in Europe to what it is today. It could take only a few years to destroy it.'*¹

The latest casualty is Ireland's Horse and Greyhound racing industry and the Irish intend to do something about it:

"... Now Ireland Prime Minister Martin Cullen has threatened to ban online sports betting unless internet operators are prepared to make a financial contribution to the Exchequer to help fund the ailing Horse and Greyhound Racing Fund.

At present, the Fund is subsidised by the Government to the tune of around Euro 1.5 million per year, although it is expected this amount will be reduced with the impact of general economic conditions in Ireland at present. And Cullen expects online betting operator to step up to the plate.

A levy of just 0.5% on internet gambling revenue would yield around Euro 100 million claims Cullen, who conceded that most punters now by choice bet online rather than with local operators.

The reality is that most betting is now offshore. There are choices to be made, and I am making it clear to the industry that we will make those choices. The ultimate choice would be to ban it. That approach has been taken in America and perhaps it will be taken in other countries as well. However, I do not want to go down that road. I believe there is a means of taking action.

*The gambling world continues to be forever changed by the online betting juggernaut.'*²

¹ EPMA, Economic and social contribution of horse racing in Europe, October 2009

² The Independent, 1 April 2009

In fact, there are no examples of a racing industry successfully transitioning from pari-mutuel to bookmakers or from addressing the ‘free rider’ issue particularly when wagering occurs beyond state or national boundaries and piecemeal initiatives are applied. This suggests a comprehensive and Australian specific response is required, given the starting point of the industry (including the prevalence of pari-mutuel), its economic and social importance and its broad consumer base.

3.2. Lessons from the UK experience

The UK has never had a significant totalisator wagering authority or pari-mutuel wagering pool, yet it provides an insight over an approximate ten-year period on the impact of a ‘gross profits tax’ (GPT) based on the net revenue of bookmakers. The starting point for the journey was the late 1990s, when many wagering operators were relocating offshore to avoid the existing UK tax regime on wagering:

‘Several environmental changes in the 1990s – including the introduction of a national lottery, the rise of Internet gambling, and the reduction of trade barriers within the EU – induced the UK government to initiate a large-scale review of betting duty. As a result of this review, the government recently announced a significant reduction in betting taxes. They also decided to replace the current general betting duty (GBD), levied as a proportion of betting stakes, with a gross profit tax (GPT), based on the net revenue of bookmakers.’¹

The same commentators observed that

‘The UK government has decided to base its betting taxation policy on economic criteria, such as reducing allocative inefficiency and maintaining competitiveness (versus offshore operators). This contrasts significantly with the approach taken by other countries such as the USA and Australia, where an assessment of the social costs of gambling has played a much more important role in the consideration of policies regarding betting activity.’

And that

‘Under the new tax regime, we predict that the UK betting industry will be better able to cope with further changes in their competitive and technological environments. The downside of the move to a GPT is that the revenue stream from betting taxes is likely to be less stable than under GBD.’

Unfortunately, the last observation has both correctly and incorrectly predicted the realities that have occurred. They were correct in projecting that the move to GPT would be less stable for betting taxes and wrong in that the industry would be better able to cope in the future. This is particularly true for

¹ Patron, Seigel and Vaughan Williams, A policy response to the E-Commerce Revolution: The case of betting taxation in the UK, The Economic Journal, June 2002.

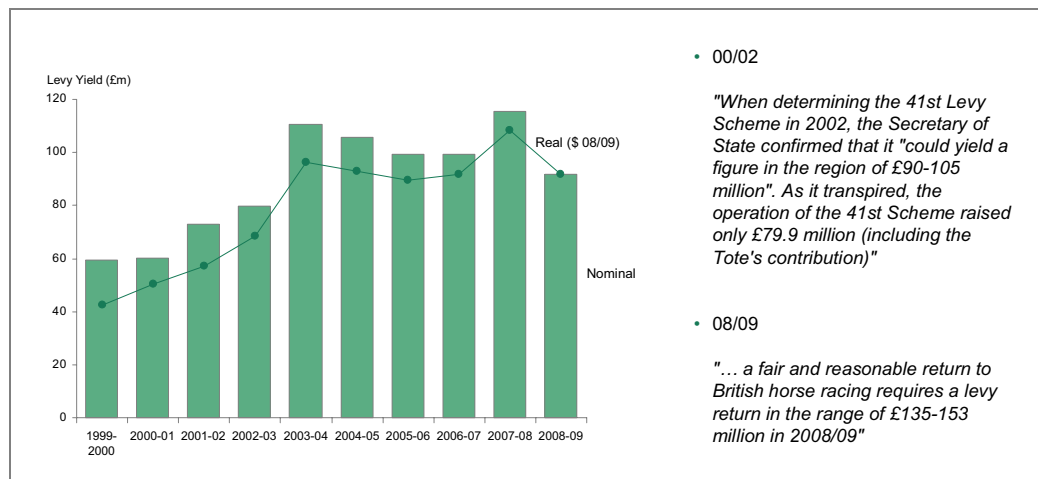
the interrelationship between the needs of the racing industry and the levy payments the formulas yield that a shift to gross profit base produced.

The debate and discussion between the early 2000s and today are well documented and are presented in the ARB Productivity Commission Submission, Appendix 6¹. The main points are that:

- *There is a history of combativeness between the wagering operators and the racing industry which the Levy Board has not been able to satisfactorily resolve.*
- *The weaknesses identified in the BMA published in October 2000 still remain. Those weaknesses are that:*²
 - *It allows the betting industry rather than the racing industry to establish a price for the product*
 - *It allows the betting industry to negotiate as a monopoly distributor*
 - *It delivers control of the acceptance or rejection of the betting industry’s offer to the three Government-appointed members of the Levy Board, leaving racing with no control over the pricing of its product*
 - *It does not permit racing to capture a share of offshore betting.*

In spite of a real increase in revenue as the ‘free riding’ was eliminated to a degree, the funding gap between the levy yield and the industry requirements is equally an issue today as it was in 2000 (Exhibit 11).

Exhibit 11: Levy yield versus thoroughbred racing’s needs in the UK



Source: BHA Submission, Determination of the 47th Horse Racing Levy Scheme, November 2007

¹ ARB, Submission to Productivity Commission Enquiry on Gambling, 2009

² British Horse Racing Board, The future funding plan for British Racing, October 2000

The shift to an industry levy based on gross profit did not yield the large increase in funding expected. Betfair analysed the shortfall in its 2003 study, *The Funding Question*¹ and concludes

‘Current accusation levelled at betting exchanges – regarding turnover, margin, punter behaviour, bookmaker behaviour, bookmaker profitability, and ultimately the funding of racing – are unfounded.’

Betfair points to the removal of betting tax in 2001 by the Government and how its impact on horserace funding was ‘dramatically underestimated’.

“The thinking at the time of the tax change was that a 45 per cent rise in betting turnover would be required to make up for the fall in margins flowing from punters not paying tax. And it was assumed punters would continue to recycle 100 per cent of their money through horserace bets.

But the forecasters failed to predict the changes in behaviour by punters as they bet more on low-margin favourites and single bets rather than multiples – and less sophisticated backers turned to roulette machine and other bookmaker products rather than just betting on horses.

The changes in punter behaviour mean that horseracing is not achieving the levels of funding it had hoped for or expected. Although turnover has increased to compensate, a full analysis shows that the change in turnover required maintaining racing’s funding following the tax change was not 45 per cent, but 95 per cent.”

In summary, the lessons from ten years of UK experience in the racing industry are:

1. It is very difficult to accurately predict future industry behaviour due to changing bases of competition, consumer preferences and the emergence of new business models.
2. Payments to support a product, an industry or a facility need to determine their own economics to endure and prosper, and not rely on the gross or net profit of those businesses that use their product.
3. A lower cost wagering model does not reduce the cost of providing the racing product.
4. The racing industry and the wagering operator must be cognisant of the consumer needs and how much the different segments are prepared to pay to enjoy the racing product.

Supporting facts, figures and arguments are presented in the various British Horseracing Authority’s recent submissions on numerous Horserace Betting Levy Schemes.

¹ Betfair, *The Funding Question*, 24 November 2003

3.3. Similarities with the online music industry

The music industry is also wrestling with some of the same issues and is embarking upon similar strategies to secure funding for the artists. The music industry has adopted a per song royalty rate. Extracts from the October 2008 article¹ outline the arrangements agreed

“The Copyright Royalty Board on Thursday froze the rate that digital-music stores, such as iTunes, must pay music publishers.

The three-member board that sets statutory copyright licences emailed the Digital Media Association (DiMA), the National Music Publishers’ Association, Apple, and other download stores with its decision to keep the royalty rate US\$0.091 cents. The board also set the same rate for CDs and mandated established a US\$0.24 rate for ringtones. The decision is the first time the Board has established mechanical royalty rates for digital downloads.

The group representing music publishers had sought a per-song rate boost from US\$0.091 cents to US\$0.15, a 66 per cent increase. Certainly, nobody can predict what Apple will do, but at this point, it looks as if the company got what it wanted. In short, Apple won.

Mark Litvack, an entertainment and copyright attorney and a former legal counsel for the Motion Picture Association of America, said rates have traditionally gone up during these kinds of negotiations. But Apple has ‘effectively set the economics of the music industry, which now appear to be frozen’.

Music industry sings the blues

The group representing music publishers applauded the CRB’s decision publicly but not everybody on that side of the debate was happy. One music industry source familiar with the negotiations, said the publishers would probably have liked more money but should be happy that the CRB didn’t attach the rate to a percentage of a music-store’s revenue.

In my dealings with music publishers, I’ve heard them complain for a long time about the US\$0.09 royalty rate. In some corners, the lack of any increase will not be received well. Nobody has been a more vocal proponent of raising rates than Rick Carnes, president of the Songwriters Guild of America. On Thursday, Carnes acknowledged he had hoped for an increase. Still, he insisted there was still plenty to be happy about.

‘What DiMA had asked for was a reduction to 4.5 cents (or 55 per cent),’ said Carnes, who has written songs for Alabama, Reba McEntire and Dean Martin. ‘When you look at 9.1 it’s only a disaster but 4.5 is Armageddon ... if you look at record sales, they’ve just been a disaster. It’s hard to go to the judges and ask for money at this point of time ... Everybody is hurting frankly and until we get a solution to the massive looting on the internet we’re not going to be able to move this thing much.’

¹ G. Sandavol, ‘Fines royalty rate stays the same’ www.applesource.com.au/news, October 2008

Mike McGuire, a music industry analyst for Gartner, said that the royalty board made a wise decision for consumers, musicians and download stores by not raising rates. The download stores are competing against piracy, and obtaining illegal downloads is simple and hard to compete with on price: they're free."

As stated, there are clear similarities with the challenges facing the online music industry and the racing industry:

- Musicians and artists are clearly facing similar issues to the racing industry, described as 'massive looting on the internet'
- A levy of US\$0.091 cents per song rate exists, and payments linked to the business model have been avoided
- Apple's iTunes set the rate and a levy increase did not get approved
- Complicated formula assessing levy from iTunes business model have been rejected.

3.4. Implications for the Australian Racing Industry

The key lessons evident from the proceeding discussion are:

- The European Racing Industry has illustrated
 - 'Free rider' wagering operators can significantly decimate the racing industry
 - The Irish Racing Industry is observing the same pattern and are looking to levy, not ban, internet operators
- The role of pari-mutuel operators (Totalisators) is vital
 - In Europe, pari-mutuel operators account for 43% of the turnover and 84% of the direct betting contribution to horse funding
 - Substantial totalisator wagering goes hand in hand with stronger return to the industry
- Lessons from the UK experience
 - In 2000, the UK moved to replace the general betting stakes, with a gross profits tax (GPT), based on the net revenue of bookmakers
 - Weaknesses have been consistently pointed out with the GPT model. These are
 - It allows the betting industry rather than the Racing Industry to establish a price for the product
 - It allows the betting industry to negotiate as a monopoly distributor
 - It delivers control of the acceptance or rejection of the betting industry's offer to the three Government-appointed members of the Levy Board, leaving Racing with no control over the pricing of its product

- It does not permit Racing to capture a share of offshore betting (BHA Levy submissions).
- The evidence clearly exists after nearly ten years, the UK Racing Industry is underfunded by the levy arrangements due to
 - Inaccurate projections of competitive and consumer behaviour
 - The linking of the industry returns to the changing (and generally increasingly lower cost) business models of the wagering operators
- There are clear similarities in the ‘free riding’ issue in the music industry that provide some relevant lessons outlined in Section 3.3.

The following section presents recommendations that build on these conclusions and those presented in the preceding sections of this submission. However, there is clear evidence that staging horse racing is a high cost activity, requiring an appropriate fee from those who wager on it. Given there is extensive competition for the wagering dollar, the horse racing must be cognisant of these competitive pressures when it prices its own product. If that fee is too high for punter, they will wager on one of many alternatives, ie, the market place will send strong signals if racing has over-priced its product.

4. RECOMMENDATIONS TO SUPPORT STRONG AND DYNAMIC RACING AND WAGERING INDUSTRIES

The challenge of developing recommendations that deliver a strong, robust and not considerably downsized industry are captured in the following quote by NERA Economic Consulting¹:

'The ways in which information technology is changing the core economic structure and behaviour of the thoroughbred racing business is of particular interest to economists, because thoroughbred racing stands uniquely at the intersection of direct economic regulation, emerging competition, and the operations of financial markets. Direct economic regulation continues to play a role in the core economic decisions: How much product will be produced, when, and by whom? What kinds of wagering will take place and at what prices? And so forth.'

In determining our recommendations the NHRA aims to:

- Develop an enduring and competitive racing and wagering industry
- Deliver on the diverse needs of its broad consumer base.

In doing so, it draws heavily upon:

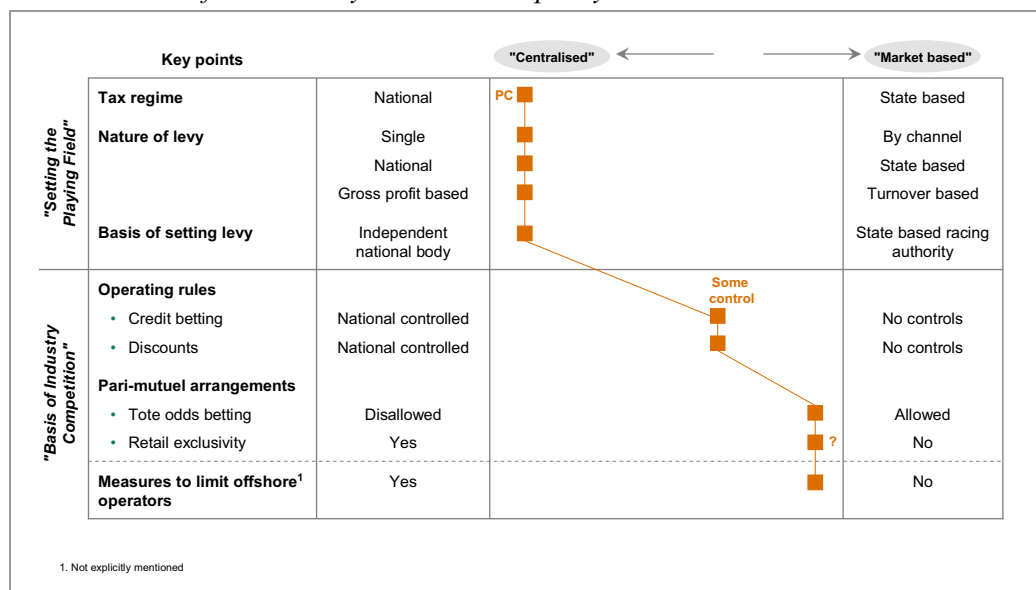
- The deep racing (and wagering) experience of its members
- The global evidence clearly outlined in the proceeding sections, and
- The recognition of the strong starting point of the Australian Racing Industry.

4.1 The Recommendations of the Productivity Commission

The key draft recommendations of the Productivity Commission are outlined at the start of Chapter 13 of the report. To illustrate the overall intention of the Commission, the recommendations have been grouped in Exhibit 12, by the type and nature of recommendation.

¹ NERA Economic Consulting, Thorough Racetrack Economics: Emerging Issues in Competition, Regulation and Wagering, 2004

Exhibit 12: Overview of Productivity Commissions policy recommendations



It appears that the Commission is mirroring the ‘UK model’ by taking an expected economists’ perspective that ‘defines the playing field’ and then effectively leaves it to open competition to deliver the industry outcomes.

The cornerstone of this recommendation is a single rate of levy across the industry, which makes no distinction between pari-mutuel and fixed odds betting, although they have quite different risk profiles. In NHRA’s view **THIS WILL LEAD TO AT LEAST A 50%, MAYBE 70% DECLINE IN THE SIZE OF THE AUSTRALIAN RACING INDUSTRY.**

The reasons for this are three fold:

1. The UK experience suggests that even starting off at a low funding base, a current levy (approximately 1% of turnover charged on gross profit basis) can not meet the needs of an industry about 20% the size of the Australian racing industry.
2. A 3-4% levy is required to deliver the outcome the Australian industry enjoys today – but this is not practical across all channels.
3. By ‘equalising the playing field’ the funds of the industry by pari-mutuel operators will be jeopardised, to the advantage of a few at the expense of the vast majority.

However, there are however areas where the NHRA agrees with the recommendations, which are:

- The need to prevent ‘free-riding’
- A harmonised national taxation agreement
- Consistent, national rules for credit betting, incentive inducements and advertising.

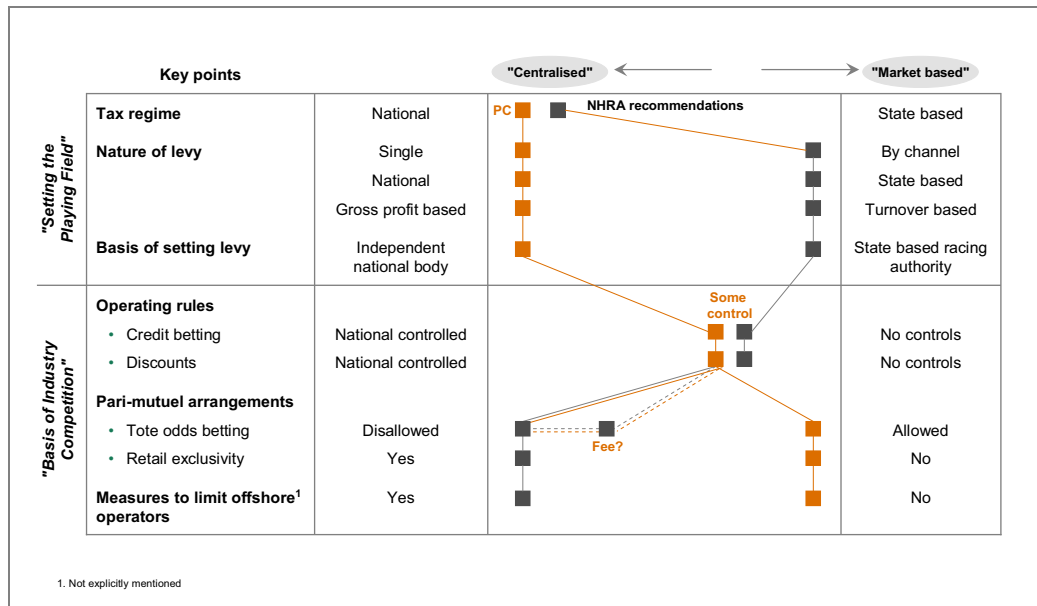
4.2 NHRA Recommendations

The group also recognises the need for a package of initiatives and not a random menu. To this end the group recommends:

- i. Ensuring the continuation of a strong pari-mutuel wagering base thereby requiring
 - Retail exclusivity for TABs
 - Banning or imposing an additional product fee for tote-odds betting
 - Measures to limit offshore wagering or to levy it effectively.
- ii. The right of the industry to develop, promote and price its product.
- iii. NHRA strongly prefers the percent of turnover levy to provide an enduring racing industry outcome.

Using the same framework as Exhibit 12, the NHRA recommendations are contrasted with those of the Productivity Commission (Exhibit 13).

Exhibit 13: Comparison of Commission recommendations and NHRA recommendations



Basically, the differences in the NHRA approach are that it allows the industry to take responsibility for the value of its product. That is, it sets the fee that consumers are willing to pay, in a way that propagates the pari-mutuel model as part of that offering and prohibiting 'free riding' off the pari-mutuel operator.

Each of these areas is discussed below.

4.2.1 Ensuring the continuation of a strong pari-mutuel wagering base

The Australian Racing Industry is in a strong position globally. It starts with a strong and robust industry and a significant contribution from the pari-mutuel wagerers. That said, new business models will grow to meet the needs of certain wagering segments which must be recognised and accommodated for in any future recommendations.

The recommendations need to ensure there is a strong pari-mutuel operator that provides a bricks and mortar outlet for the large social or recreational wagering segment. The contribution from the pari-mutuel operator, that is, the TAB, will be greater to the racing industry per dollar of turnover than the lower cost online operators. For example:

- 5.0-5.5% racing industry fee on pari-mutuel wagering turnover
- 1.5% racing industry fee on fixed odds betting and betting exchange turnover.

A result of determining that pari-mutuel wagering through bricks and mortar is a critical component going forward. The implication in the market place is that there will be competing operators with different cost structures, resulting in different take out rates or prices, that is:

- ~14-16% for pari-mutuel
- ~8% for corporate operators
- ~5% for exchanges.

To ensure fair competition between these operators, three additional policies must be in place, which address tote-odds betting, retail exclusivity and off-shore wagering prohibition or levying.

Tote odds betting relies on a take-out differential between operators. The lower cost operator offers a premium over the high cost (bricks and mortar pari-mutuel) operator and then offloads his/her risk through using the pari-mutuel operator at a discounted rate. Under the Productivity Commission recommendations, this advantage is unlikely to exist, but as experience has pointed out, neither will the racing industry in its current shape or size. Accordingly, to overcome this arbitrage opportunity available through TABs, either tote odds betting is banned or there is an additional product fee paid to the industry for this type of wager that neutralises the advantage.

Retail outlets account for 70% of the turnover in the industry. *Retail exclusivity* allows for the materially higher product fee to be levied. Without retail exclusivity, competing outlets would proliferate (most likely in an unacceptable manner to local authorities) and the basis of competition between relatively undifferentiated offerings would become cost based. Again, international experience and modelling of forecast industry returns would suggest that this as a significantly value-destroying strategy.

Finally, *preventing 'free riding' by off-shore operators* is the third leg of the stool to support differential channel fees. The NHRA is confident that a balanced set of recommendations will not result in a mass migration of operators to offshore jurisdictions. However, the industry and the regulators must constantly monitor the increasing international activity of 'bet anywhere on anything'. Accordingly, off-shore bookmakers should not be permitted to 'free ride' on the Australian Racing Industry going forward. The Interactive Gambling Act (IGA) should be amended to extend the exceptions only to operators who have the requisite approvals to use racefields or the like and comply with the credit and problem gambling prevention policies of Australia.

4.2.2 The right of the Racing Industry to develop, promote and price its product

The starting point for this recommendation is that there is agreement on the need to prevent 'free riding' where wagers could take bets on the outcome of races without having to make any payment to the Racing Industry.

In the NSW RICG submission to the Productivity Commission on 1 December 2009¹, the Group's position was clearly stated as follows, with four key supporting points outlined.

RICG argued, and NHRA agrees, that there was no need for a national regulator to set race fields because:

- i. *Race clubs are in an ideal position to set race field fees and currently play a key role in the setting of such fees through their close working relationship with state bodies.*
- ii. *There is now sufficient and growing wagering competition in the industry to discipline price and service offering provided by the industry.*
- iii. *The cost of the regulatory arrangement proposed by the Commission could be high and, to the extent that the arrangement is unnecessary, a drain on the industry and the community at large.*
- iv. *A single, uniform levy is likely to stifle innovation with respect to the development of superior race products.*

A review of the UK processes using a similar approach through the Levy Board and supporting information indicates considerable effort and debate to reach an outcome that does not seem to be embraced by any party.

More importantly however, it must fall to the Racing Industry to set its product fees. The industry fully realises it faces intense competition for both the broader discretionary spend and the wagering dollar. A review of the betting options available in Australia today presented by Tabcorp in its April 2009 submission to the Productivity Commission outlines the choices. With these choices and the growing interest in sports betting (and even virtual racing), there is significant pressure on the industry to understand its consumers, and there is competitive pressure on the product and set levies

¹ NSW Racing Industry Consultation Group, Response to Productivity Commission Draft Report on Gambling, December 2009

that drive wagering turnover across all channels, whilst maintaining high consumer interest in the product.

4.2.3 Basis of funding

There has been considerable debate both within Australia and globally on the basis of the levy. The RICG approach was outlined in the submission presentation of 1 December 2009.

In our view, if there is to be a single, national levy – something that for the reasons I have already set out, we are strongly opposed to – turnover is a more appropriate basis for the levy than gross revenue.

It is important to keep in mind that the racing industry levy is designed to recover some of the cost the racing industry incurs in providing the race fields that the punter can wager on.

Under a turnover approach wagering providers pay the same dollar fee for a piece of race fields' information. The cost of this information as a proportion of total wagering provider costs differs significantly across the types of wagering provider. However, this is completely irrelevant for the design of a levy to recover some of the cost that the racing industry incurs in providing race fields. The only way that it might be relevant is if the Federal Government were to require the national regulator to intervene so as to socially engineer the wagering market to realise a prescribed industry configuration that has a higher concentration of low cost (low quality) wagering services than would prevail absent such engineering. However, this type of social engineering should not be confused with the emulation of a competitive market.

Turnover has also always been the currency in racing and wagering. It is easily understood, easily calculated and universal to all wagering operators who all calculate their operations based on turnover.

The calculation of gross revenue, on the other hand, tends to differ across operators and is more readily manipulated by operators. It also makes Racing Clubs more exposed to the market risks faced by wagering operators. It is not clear why the Commission would find this desirable, as Racing Clubs are not well placed to manage these risks. It also exposes the funding of racing events to large and unexpected variations as a result of differences in the performance of individual wagering operators.

NHRA also holds the fundamental belief that policy should not inhibit business model innovation but the industry needs to take the appropriate sliver of the value chain as a levy directly from the punter. This levy is set at what punters are prepared to pay to support the industry. Its size may be small or large but is unrelated to the costs or gross margins of the wagering operators.

Consideration of the global evidence presents three conclusions, those being:

- The economics of racing and a fair contribution from all channels are closely interlinked
- The economics of the Racing Industry are not the economics of wagering operators – in other words, lower cost internet-based wagering channels do not result in a reduced cost to produce the wagering product (or an off-setting increase in revenue)
- Projections of levies based on today’s wagering economics and consumer preferences will not necessarily represent the relationship in five or 10 years time.

A recent example of the divergence of returns between the racing and wagering industry and the means of assessing the levy are illustrated below:

<p>Wagering and the 2009 Melbourne Cup</p> <p>The three TAB’s held \$167 million on the 2009 Melbourne Cup. On a turnover model the industry generated about \$10 million in net revenue to fund racing operations and prize money.</p> <p>The Corporates said there was significant backing for Shocking and that they broke even at best.</p> <p>Leading Bookmaker Alan Eskander said he lost \$100,000 on Shocking in one bet of \$10,000 at \$11. He made the following comment:</p> <p><i>“The two favourites were going to be disasters for us. If you put all that in the wash, we ended up breaking even on the Cup. I reckon I would have won or lost a round of drinks on the Cup, but over all I’ve won, I’ve had a good day.”</i></p> <p>Under a gross profit model, 15% of a break even result equals zero. Under a 1.5% turnover model the bookies would have contributed \$2.5m. Although significantly less than the TAB contribution, the turnover model ensures the industry is guaranteed to get something back from corporate bookmakers.</p>
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Accordingly, NHRA’s recommendations are:

- v. That a turnover-based levy is a viable alternative to a gross profit levy
- vi. A levy based on turnover is superior to a gross profit levy

4.2.4 Integrity and problem gambling

Again, these topics have received considerable attention given the new forms of wagering that make ‘profits for losing’ a viable wagering strategy and increased disintermediation between the wagering operator and the society in which the punter lives. NHRA has ‘coal face’ experience in the racing and wagering industries and strongly believes policy initiatives are required in this area.

With respect to integrity, a cornerstone of the racing industry, NHRA supports the ARB recommendation that:

...With the growth of telephone and internet betting, the amount of wagering on racing events which is conducted with wagering operators licensed in other States has increased significantly. Prior to race fields legislation The Controlling Bodies had no right of access to wagering data and betting information from many of the interstate wagering operators to assist in the performance of their integrity functions (eg. Stewards investigations) notwithstanding the potential for betting with such wagering operators to be associated with the integrity issues.

*Some interstate wagering operators have readily agreed to provide access to wagering and betting data and to assist the Controlling Bodies in relation to inquiries and investigations regarding racing integrity issues. **However, given the potential for integrity related issues, the provision of such information needs to be mandatory.***

Two recent developments have significantly changed the shape of wagering. Firstly, traditional boundaries no longer apply, meaning the separation between the wagering organisation's profits and the wagerer, potentially a problem gambling candidate, has increased. Secondly, the number and level of competition between wagering operators has significantly increased. An example of this has been the advertising blitzes to enlist wagering funds during recent major Australian racing carnivals. To this end, NHRA recommends:

- Taking the Productivity Commission's recommendations further in that national guidelines be established on controlling and limiting
 - credit betting
 - inducements and rebates
- That a national set of advertising regulations that minimise the risk of problem gambling being exacerbated are put in place.

Finally, the group believes there is merit in establishing a problem gambling levy based on turnover. Such a regime exists in New Zealand¹ (at 0.55% of NZRB profits), but it could better be applied to turnover in the range of 0.1%.

4.3 The package of initiatives

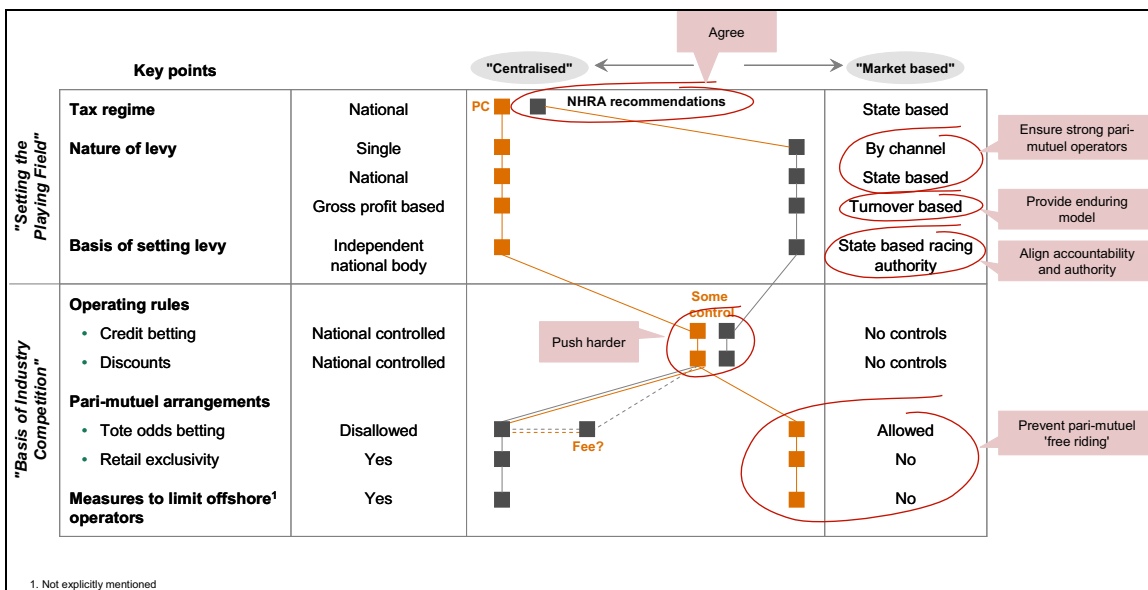
As stated at the beginning of this chapter, NHRA's objective is to deliver strong and enduring racing and wagering industries in Australia. It has elected to do so through a number of mechanisms outlined in Exhibit 14. These represent a comprehensive approach to delivering these objectives by

¹ New Zealand Inland Revenue website; *Problem Gambling Levy*

promoting a strong pari-mutuel wagering sector, complemented by new business models that no longer allow 'free riding'. The primary differences between the Productivity Commission recommendations and NHRA's are:

- A higher pari-mutuel levy rate versus online channels
- Mechanisms to support the higher rate and prevent new forms of 'free riding' – that is, tote odds betting, retail exclusivity and regulations for international operators
- The alignment of authority and responsibility for the Racing Industry to set this rate and determine its own future
- The preference of a levy based on turnover as an enduring robust mechanism
- Further strengthening of integrity disciplines, and
- Additional controls to limit the risks of problem gambling.

Exhibit 14: Summary of rationale of NHRA recommendations



The difference in the net result between the NHRA recommendations and those of the Productivity Commission will be in the future size and strength of the industry, reflected in its economic, tax and social contribution. Significant downsizing is neither desirable nor a pre-requisite for success.

5. SUMMARY OF RECOMMENDATIONS

The NHRA stresses the need for enduring funding arrangements for the racing industry on which the wagering industry depends for its prosperity.

The key points of the NHRA recommendations are:

- Ensuring the continuation of a strong pari-mutuel wagering base thereby requiring:
 - Higher levy rates for pari-mutuel wagering than fixed odds betting
 - Retail exclusivity for TABs
 - Banning or imposing an additional product fee upon bookmakers for tote-odds betting
 - Measures to limit offshore wagering or to levy it effectively
- The right of the industry to develop, promote and price its product
- A strong preference for a percent of turnover levy
- Further strengthening of integrity disciplines
- Additional controls to limit the risk of problem gambling

In addition, NHRA supports the direction of the Productivity Commission recommendations with respect to:

- The need to prevent ‘free riding’
- A harmonised national taxation agreement
- Consistent, national rules for credit betting, incentive inducements and advertising.



Sky Racing STV Ratings

Measure	WC 2/11/2008 CUP WEEK	WC 06/09/09	WC 13/09/09	WC 20/09/09	WC 27/09/09	WC 04/10/09	WC 11/10/09	WC 18/10/09
Sky Racing Weekly Reach(metro/reg)	821,299	629,427	647,342	620,285	651,259	600,054	732,860	726,466
TVN Weekly reach (Metro only)	370,254	219,848	245,315	257,027	253,753	232,519	303,564	315,757
Sky Racing avg rch. Sat/Sun 12-530pm(metro)	254,993	260,496	265,815	247,989	275,741	249,663	337,829	319,197
TVN avg.rch Sat / Sun 12-530pm(metro)	109,330	102,418	128,596	113,026	151,064	123,412	155,732	174,683
Sky Saturday projected audience 12-530pm		59,886	85,508	54,527	81,697	72,267	84,976	56,892
TVN Saturday projected audience 12-530pm		30,454	27,862	13,157	47,293	33,506	55,667	44,207
Sky Racing Retro reach	17,351	12,335	14,193	26,208	19,665	5,091	4,674	8,452
TVN Racing Review reach	6,833	3,083	6,439	4,799	5,769	1,316	3,103	2,405
Sky ranking Men 25+ Sun/Sat 12-3pm	1	2	2	2	2	2	1	1
Sky ranking Men 40+ Sun/Sat 12-3pm	1	1	1	1	1	1	1	1
Sky ranking Men 25+ Sun/Sat 12-530pm		3	3	3	3	3	3	3
Sky ranking Men 40+ Sun/Sat 12-530pm		2	2	2	2	2	2	2
Avg Time spent viewing per day	23m43s	21m26s	28m26s	22m	24m34s	23m17s	21m09s	18m26s

Facts:

73% of Sky audience are male

70% of Sky audience are men 25+

On average Skys weekly audience reach is more than double that of TVN

On average Skys Sat/Sun audience reach is more than double that of TVN

Sky is consistently the most watched channel on STV on Saturday 12-3pm for Men 40+

Sky is consistently in the top 3 most watched channels on STV on Saturday 12-530pm for Men 40+ and Men 25+