

HORSERACE BETTING AND OLYMPIC LOTTERY BILL

REGULATORY IMPACT ASSESSMENT

**Prepared by the Department for Culture, Media and Sport
December 2003**

Overview

1. This Regulatory Impact Assessment (RIA) covers the impact of measures to be included in the Horserace Betting and Olympic Lottery Bill.
2. The Bill consists of two key parts. First the Bill addresses the Government's remaining involvement in the administration and financing of horseracing. Specifically, it allows for the sale of the Horserace Totalisator Board (the 'Tote') and the abolition of the Horserace Betting Levy Board (the 'Levy Board').
3. Second, in the event that London is chosen to host the 2012 Olympic and Paralympic Games, the Bill enables dedicated Olympic Lottery games to be established as part of the National Lottery. It also creates the necessary structures for holding the proceeds from these Lottery games and a distribution mechanism that will enable those proceeds to be used to meet expenditure in connection with the staging of the Olympic Games.
4. Detailed separate Regulatory Impact Assessments have been prepared for the three key policy proposals in the Bill:
 - A: Sale of the Totalisator Board
 - B: Abolition of the Horserace Betting Levy Board
 - C: Olympic Lottery games

Declaration

I have read the Regulatory Impact Assessments and I am satisfied that the benefits of each justify the costs.

Signed



Rt. Hon Richard Caborn MP
Minister for Sport and Tourism
December 2003

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A: SALE OF THE TOTALISATOR BOARD: REGULATORY IMPACT ASSESSMENT

Purpose and intended effect

1. The purpose of the measure is to vest the assets of the Totalisator Board (the 'Tote') into a company owned by the Secretary of State and to allow for the sale of that company. The measure will also allow for the abolition of the Tote Board.
2. The effect of the measure will therefore be to transfer the Tote into the private sector. The Government's preferred policy is to sell the Tote to a consortium of racing interests known as the 'Racing Trust'.

Devolution

3. The measure extends to Great Britain.

Background

4. The Tote is a body corporate, established in 1928 by the Racecourse Betting Act and now administered under the Betting, Gaming and Lotteries Act 1963 (the 1963 Act). The Tote has an exclusive statutory right to conduct or authorise others to conduct pool betting on British horseracing¹. It now also conducts non-pool betting in respect of horseracing and other events and owns a significant number of betting shops (435 in 2003), a credit betting business and an Internet betting site.
5. The Tote was set up to provide an alternative to fixed odds betting and so its profits could be used to improve breeds of horses and the sport of horse racing. The Tote's profits, over and above those that are required for reinvestment, remain within racing. It does this through its contribution to the Horserace Betting Levy Board, payments to racecourses and its sponsorship programme. The Secretary of State for Culture, Media and Sport appoints the Tote Board, but has no voting rights on the Board. She does not act as guarantor or provide any financial support.
6. The status of the Tote was reviewed in 1998/99. The Review (led by the Tote chairman, Peter Jones) reported in March 1999. It recommended that the whole of the Tote business be sold as a single entity. The Government agreed with this recommendation and announced in March 2000 its intention to sell the Tote to a 'Racing Trust' that is a consortium representing British horseracing interests. The trust proposed would have an independent chairman, members representing the British Horseracing Board and its own shareholders, a member representing the Tote's staff and one independent member representing the ordinary punter. The Government's preferred option of a sale to racing recognises racing's unique interest in the Tote, as the initiator of proposals for a Tote, the historical beneficiary of profits and the principal provider of its income. The Tote review also considered the merits

¹ Pool betting is a form of betting where all the stakes on a given event are pooled and the pool, less a deduction for the operator, is divided amongst the winners. Unlike 'fixed odds' betting, the punter does not know what their exact winnings might be at point when the bet is struck. Pool betting is also referred to as totalisator betting.

of the status quo, a gift to racing and the break up of the business (with the pool betting operation being gifted to racing). Notwithstanding its preferred option, the measure proposed provides the Government with flexibility as to other possible sale methods, including a public sale.

7. This RIA was developed with assistance from PriceWaterhouseCoopers LLP (PWC), who undertook analysis of the costs and benefits of the options described below, and also undertook an assessment of competition issues arising from the measure. The final document is, however, a statement of the Government's position.

Regulation of betting

8. The measure proposed does not address future arrangements for the regulation of betting. This is addressed by Government proposals to create a Gambling Commission. The Government's proposals for a Commission were outlined in "A Safe Bet for Success"(Cm 5397), which was published in March 2002.

Risk assessment

9. The measure is concerned with a number of risks. These are most sensibly described in terms of the positive outcomes associated with the achievement of the Government's objectives for the sale of the Tote:

- The business should be sold as a single entity;
- The sale should not impede the Tote's commercial development;
- The sale should not entail a reduction in the level and nature of horserace betting opportunities. In particular, an accessible, quality pool betting service should be available at each horse racecourse in Great Britain, where the pools available are sufficiently robust as to provide a competitive alternative to other betting products, principally fixed odds betting;
- The financial interests of both the taxpayer and Racing should be safeguarded in any sale structure. Moreover, following the sale, the Tote should continue, in its new form, to provide a consistent stream of income for the horseracing industry; and
- The sale should reduce uncertainty over the Tote's future and any impact this might have on the business

Business sectors affected

10. The business sectors affected fall into five groups: the Tote and its staff, the horseracing industry, betting providers, betting consumers and the taxpayer (the Government).

The Tote and its staff

11. The Tote is a body corporate that was established in Britain in 1928 to offer pool betting on racecourses. The Tote is now the UK's fifth largest betting organisation, operating a chain of 435 high street betting shops in 2003, with a pool betting service at all 59 British racecourses and telephone and Internet betting services. There are five divisions: Tote Racecourse Division operates betting points

at all racecourses; Tote Bookmakers has offices on the high street and at racecourses; Tote Direct allows off-course bets from commercial bookmakers to be transmitted into the Tote's pools; Tote Credit Club provides telephone and on-course betting for members; and Tote betXpress offers Internet betting.

12. In the year to 31st March 2003, the Tote produced turnover of £916 million (up 43% on the previous year) and net profit of £18.7 million (up 7%). They made a contribution to racing of £10.7 million. Only some 22% of Tote betting turnover now derives from pool betting. In 2003, the Tote employed 851 full-time and 1,707 part-time employees, and 1,344 casual and supplementary staff, in racecourses, betting offices and administrative offices across the country.²

Horseracing industry

13. There are 59 horse racecourses in Great Britain where the British Horseracing Board runs races. There are three large groups: Northern Racing Ltd manage 9 courses; Arena Leisure PLC manage 6 and The Jockey Club (through their subsidiary, Racecourse Holdings Trust) own 13 courses. The remaining courses are owned independently.

14. In 1996, the horseracing and associated breeding industry directly employed some 35,500 people in Great Britain, including some 11,000 in racecourses, nearly 20,000 in breeding and training, 3,000 on-course bookmakers and about 750 jockeys and support staff³. Including indirect employment, the BHB estimates that the industry supported approximately 60,000 jobs in Great Britain and is a major employer in rural areas.

15. In 2002, an average of 13,182 horses were in training (above the twenty year average of around 12,200) and approximately 9,000 individuals, partnerships and companies owned these. Total prize money was £84.2 million. The Horserace Betting Levy Board (HBLB) contributed 46.8% of this total. The remainder came from sponsors (37.5%), owners (14.1%) and other sources (1.5%).⁴ Prize money only provides an average of 22% of the costs of ownership.

16. In 2002, there were 7,691 races during 1,158 fixtures. A total of 5,557,758 persons attended horse races. HBLB data⁵ for 54 of the 59 racecourses show that total attendance at the 1,079 race meetings in 2002 was 5.2 million, with average attendance of 4,800. 8.5% of meetings had an attendance of less than 1,000, while 9.4% of meetings had an attendance of over 10,000. Nine racecourses had an average attendance at meetings of less than 2,000, while eight racecourses had an average attendance of over 10,000.

17. The average number of meetings per racecourse was around 20, with the vast majority of courses having between 10 and 25 race meetings. This reflects the need for careful turf management. Three racecourses, however, ran much larger numbers of meetings because they have dirt tracks.

² Source: The Tote

³ Source: KPMG survey for the BHB

⁴ Source: BHB (all data in Paragraph 7)

⁵ Source: Horserace Betting Levy Board website: <http://www.hblb.co.uk>

18. There are over 7,000 thoroughbred breeders in the UK, though only a fraction of these, about 350, are engaged full time. By far the majority combine breeding with farming activities, especially for national hunt horses. The principal firms involved in the sale of horses at auction are Tattersalls and Doncaster Bloodstock Sales, which together accounted for over 95% of the market in 1999.⁶

Betting companies

19. The betting industry employs approximately 40,000 people across Great Britain⁷. Bookmakers operate at horse racecourses, through licensed betting offices, over the telephone and through the Internet. In 2000, there were approximately 8,750 licensed betting offices across Great Britain and 3,800 bookmakers' permits in force. Five companies account for around two thirds of betting turnover - Ladbrokes (26% of off-course turnover), William Hill (22%), Coral (12%), Stanley Racing (6%) and the Tote (2%). In addition, there is a proliferation of smaller regional betting office companies (32% of off-course turnover) and a considerable number of one-person enterprises (mostly bookmakers standing at racecourses).⁸

20. A number of companies, known as betting exchanges, also offer services over the Internet where consumers can accept and offer bets on horseracing. The largest of these companies is 'Betfair'. There are also companies that offer spread betting.

21. Some £4,400 million (72% of total off-course betting turnover) was bet off-course on horseracing in Britain in 1997⁹. According to the Association of British Bookmakers (ABB), horseracing used to account for around 85-90% of turnover twenty years ago, and the decline is due to the growth of betting on greyhounds, football and, to a lesser extent, numbers betting. Rings and rails bookmakers were believed to account for some 78% of on-course betting at horse races in 1997, a further 18% is spent on the Tote and the remainder in on-course betting shops. On-course betting turnover in 1997 at horse races and greyhound tracks was estimated to have been around £700 million, less than a tenth of overall betting turnover¹⁰. Pool betting on horseracing, with turnover of around £300 million, accounts for approximately 4% of total betting on horseracing in Britain¹¹.

Betting consumers

22. The Prevalence Survey in 2000 indicated that 13% of the British adult population (approximately 5.7 million individuals) placed a bet on horse races at least once in the year prior to the survey date (June 2000) and 3% (approximately 1.3 million individuals) had placed a bet in the week immediately before the survey date¹².

⁶ Source: KPMG survey for BHB

⁷ This figure includes on-course betting employment. As the majority of off-course betting is on horseracing (see Paragraph 12), much of the off-course employment may be reliant on horseracing as well.

⁸ Source: "Ladbroke Group Plc and the Coral betting business", MMC September 1998, Cm4030

⁹ Source: "Ladbrokes Group Plc and the Coral betting business", MMC September 1998, Cm4030

¹⁰ Source: "Ladbrokes Group Plc and the Coral betting business", MMC September 1998, Cm4030

¹¹ Source: PwC estimate based on Tote and MMC data.

¹² Source: "Gambling behaviour in Britain: Results from the British Gambling Prevalence Survey", National Centre for Social Research, 2000

Issues of equity and fairness

23. The proposal is not intended to address a current inequality and will not introduce any new inequality.

Options

24. The policy options under consideration are based on two possible changes:

- The sale of the Tote as envisaged by the DCMS sale strategy. The Tote would be reconstituted as a Limited Company whose shares would be held by the Racing Trust described above; and
- The retention or removal of the Tote's exclusive licence for the operation of pool betting on British horseracing, both on-course and off-course.

25. There are three options under consideration:

- **Option 1: No change**, with the Tote operating as at present in the public sector with an exclusive right to conduct pool betting on British horseracing;
- **Option 2: The sale of the Tote** as envisaged by the Government's sale strategy, and its operation as a private company **with a time-limited exclusive licence** for pool betting on British horseracing; and
- **Option 3: The sale of the Tote** as envisaged by the Government's sale strategy, and its operation as a private company **with a time-limited non-exclusive licence** for pool betting on British horseracing.

26. The measure gives flexibility for a sale to buyers other than the Racing Trust and does not make any provision for the future licensing of pool betting. Nonetheless, the Government is conscious that the continuing status of the Tote in relation to pool betting, and its relationship with horseracing, are matters of close interest to the horseracing industry, the other business sectors affected, punters who bet with the Tote and the general public.

Analysis of risks

27. The three options pose varying risks to the Government's stated policy objectives for the sale of the Tote. The analysis below considers these potential risks to each of the policy objectives in turn.

Objective 1: The business should be sold as a single entity

28. All the options involve the continuation of the Tote as a single entity. There is, therefore, no risk associated with this policy objective.

Objective 2: The sale should not impede the Tote's commercial development

29. The commercial development of the Tote requires access to funding. Under a sale to racing there is a risk that the sale funding arrangements may limit the Tote's ability to raise further funding for business growth.

30. There is a theoretical risk that the Racing Trust will not be an effective commercial owner of the Tote. The trust will reflect a range of interests within racing, who may not provide consistent strategic direction or they might become excessively involved in day-to-day operations. It will be necessary for the trust board to be structured appropriately and its rights and powers balanced with those of executive management. As improving the commercial performance of the Tote is in the interests of racing, it is reasonable to expect the trust to put in place sufficient commercial incentives, operating autonomy and fiduciary responsibilities to ensure that the commercial development of the Tote is not impeded.

Objective 3: The sale should not entail a reduction in the level and nature of horserace betting opportunities

31. The Government wishes pool betting to be provided at all 59 British racecourses. So long as there is an exclusive licence the Tote could reasonably be expected to maintain a universal service. If there were immediate scope for other pool betting licences under Option 3 then there is a risk of loss of service at some courses. The proposal to allow a reasonable period of exclusivity before the pool betting market is opened to competition is intended to ensure that the Tote is properly prepared and so that when competition comes it is vigorous.

32. Larger pools are inherently more profitable. The attractiveness of pool betting increases with the size of the pool and unit operating costs tend to fall with pool size. The Tote cross-subsidises less profitable operations, ensuring staffing and service levels that might be seen as 'irrational' in a competitive market.

33. The profitability of on-course pool betting operations is likely to be closely related to racecourse attendance. HBLB data for 54 of the 59 racecourses show that while the average attendance per race meeting was around 4,800, some 8.5% of race meetings had an attendance under 1,000 and 34.4% of race meetings had an attendance under 2,000. Moreover, nine of the 54 racecourses had an average attendance of less than 2,000 during 2002.

34. In addition, the facilities for off-course and course-to-course betting have an effect on pool size (and thus cost margins). There is a risk that multiple licences could lead to operations that are unable to capture the off-course betting market and so lose out on this source of betting, putting the viability of pool betting operations in doubt. However, as the Tote currently offers this facility it is likely to continue to do so in the future. On the other hand, the relatively low cost of pool betting technology and improved communications suggest that a provider ought to be able link up with other courses and with high street betting shops.

Objective 4: The financial interests of both the taxpayer and Racing should be safeguarded in any sale structure

35. The source of the taxpayer's legitimate interests in the sale of the Tote derive from two sources:

- Parliament has vested something of value by granting an exclusive right to the Tote and by giving it powers to undertake other activities; and
- Government creates the conditions for realising value by legislating for the sale of the Tote,

36. Both Option 2 and Option 3 would generate sales proceeds, although it is possible that proceeds would be lower without an exclusive licence. The envisaged sale to a Racing Trust is likely to provide a lower level of proceeds than other possible options, such as a trade sale to the highest bidder. The value of the Tote is likely to be lower for the Trust as it would not benefit from synergies that may be available to other purchasers.

37. The financial interests of racing are the counter-part to the interests of taxpayers. To the extent that the sale will be financed by debt held by the Tote, future contributions to racing will be reduced by the amount of interest paid on that debt. However ownership by the trust will ensure a continuation of the beneficial relationship between the Tote and racing.

38. Racing may receive less ongoing income under Option 3 compared to Option 2 if the lack of an exclusive licence reduces the net profits of the Tote as its volume of pool betting falls. This loss would be partly offset by higher contributions made by competing operators that benefit from access to the pool betting market. However, such payments would be at the commercial level, rather than the contributory payments, designed to benefit horseracing, offered by the Tote. Any changes in valuation due to the nature of the licence granted should be reflected in the price paid for the Tote.

Objective 5: The sale should reduce uncertainty over the Tote's future and any impact this might have on the business

39. Both Option 2 and 3 would remove uncertainty about the Tote's future. Under Option 3, the prospect of losing the exclusive licence would, however, introduce a new source of uncertainty for the Tote and its staff in the form of the need to be competitive with other pool betting operators. Option 2 would provide greater immediate certainty as it would maintain its exclusive licence while uncertainties surrounding ownership would be removed. Even if the exclusive licence were not preserved in perpetuity there would be considerable time to prepare for any change.

Benefits

40. The analysis uses Option 1 as a base case against which the benefits of Option 2 and Option 3 are judged. It should be noted that many of the benefits arising are transfers that have equal and opposite costs for other stakeholders. These are included in the costs section below.

Benefits of Option 2: (Sale of the Tote with an exclusive licence)

The Tote and its staff

41. The central benefits to the Tote of Option 2 arise from the maintenance of its current position as the sole provider of pool betting services and its sale as a single entity. This provides a basis on which the Tote would be able to continue its autonomous commercial development.

42. Less certain are possible benefits to the Tote and its staff that could arise if private ownership increases commercial incentives. International data on the management costs of pool betting operations overseas¹³ suggest that the Tote's costs, at 3.8% of turnover, are about average. The data should be treated with caution, however, due to the difficulties in comparing costs internationally. The countries with the lowest reported management costs are the United States (1.7% of turnover) and Hong Kong (1.4%). Both have much higher turnover than the Tote, providing greater advantages of scale¹⁴. In addition, tracks in the US are predominantly dirt tracks, and therefore can run a far higher number of races per track, so that equipment is installed permanently rather than needing to be moved around. Cost comparisons are therefore particularly difficult.

43. As an illustration, if the Tote reduced its costs by 1% of turnover, this would increase its profits before contributions to racing and taxation by around £3 million per annum, or 15-20% (assuming that deductions were not changed in response). This amount could be passed on to the horseracing industry as a significant increase in contributions. Any significant reduction in management costs would be likely, however, to be driven by a significant reduction in Tote employment.

44. The Tote may benefit from the sale if it improves its access to private finance. For instance, if the Tote were to issue bonds to finance capital expansion, this could enable the Tote to develop its business free from existing financial constraints. Access to private finance may, however, depend on the structure and nature of the Racing Trust. It does seem more likely than not, however, that the sale would improve access to finance and that this would be a significant boost to the Tote.

Horseracing industry

45. The horseracing industry in general should benefit from the sale of the Tote, as it would nominate most of the racing trust. Industry influence over the Tote would, therefore, be likely to be greater, although the breadth of different organisations involved in nominating the trust committee limits the influence of any single organisation. Benefit to the industry could arise from closer alignment of the interests of the Tote with those of the industry, perhaps from having a greater influence over the direction of Tote sponsorship. The Tote already has strong links with the racing industry, however, so this benefit is unlikely to be significant.

46. More significantly, the sale of the Tote with its exclusive licence intact and with its ownership vested in the trust, would ensure that all pool betting profits (and any extra net profits derived from efficiency improvements) would continue to be passed on to the horseracing industry as extra contributions, with most of the extra money flowing to the racecourses as extra sponsorship and racecourse payments. On the other hand, the funding of the sale would reduce those contributions for a period,

¹³ Source: International Federation of Horseracing Authorities, <http://www.horseracingintfed.com>.

¹⁴ This factor is particularly pertinent for Hong Kong, which only has two racecourses.

whereas sale on the open market would produce an immediate cash benefit for racing in the form of a share of the proceeds as well as enabling racing to continue to receive payments from the Tote for use of pictures and data on the same basis as other bookmakers.

Betting consumer

47. The consumer is unlikely to receive any immediate benefit from the sale of the Tote as envisaged by Option 2. There would be a benefit in the sense that the levels of service provided at present by the Tote would be maintained into the future, and greater access to private finance that is not currently available may afford opportunities for the Tote to then enhance service. Customers would also be assured continuing access to robust pools.

Taxpayer

48. The Government has indicated that it regards the taxpayer as one of two interests in the Tote, the other being the racing industry. Consequently, Government would expect proceeds equal to around one half of the Tote's value at sale.

49. If the performance of the Tote were to improve because of the sale, then the taxpayer could benefit from increased receipts from Gross Profit Tax. The overall effect is likely to be tax neutral as an increase in demand for the Tote's products will probably be offset by lower tax revenue from other competing operators.

Benefits of Option 3: (Sale of the Tote without an exclusive licence)

50. The benefits of selling the Tote to a Racing Trust whilst removing the exclusive licence for pool betting would accrue principally to the horse racing industry and betting providers through opportunities to enter pool betting and the strong incentive for efficiency as a result of competition. Punters could also benefit, for example from lower prices, as they would have a choice between pool betting suppliers but only where one or more suppliers chose to offer pool betting.

The Tote and its staff

51. Without an exclusive licence, the Tote may no longer be obliged to run pool betting operations at all race meetings or racecourses. As noted above, the Tote may be involved in considerable cross subsidising of its less profitable pools operations at smaller racecourses. Removing the universal service obligation would be expected to encourage the Tote to become a more efficient operator by closing or rationalising loss-making operations to reduce costs. The extent to which racecourses are inherently loss making is uncertain because costs could be cut if the Tote offered a less extensive service at some racecourses.

52. The Tote would only benefit from increased freedom if it were able to compete effectively against other potential pool betting operators. It would have a 'first mover advantage', with an existing, widely recognised, brand. It would not face any start up costs, unlike potential competitors, and has substantial capital assets at racecourses and standing contracts that provide it with prime positions at racecourses.

53. However, if increased competition were to improve the image of pool betting, for example through increased advertising, it may grow the market as a whole. The Tote may, therefore, benefit even in its pool betting operations from increased competition.

54. The extent to which the Tote could maintain its presence in pool betting without an exclusive licence is uncertain as it depends on the commercial interests of alternative suppliers. It seems unlikely that the Tote would enjoy an overall benefit as pool betting revenue may be lost and there seem likely to be reductions in Tote employment.

Horseracing industry

55. Without an exclusive licence, racecourses would have the opportunity to be more directly involved in the operation of on-course pool betting, perhaps in conjunction with a larger betting provider. This might allow the racecourses to capture greater value from the operation. Access to off-course and course-to-course pool betting revenue would be possible as is currently the case with the Tote.

56. Greyhound racecourse operators have their own pool betting operations and extract a high level of deductions from punters, although this might well reflect the weakness of competition from the bookmakers at greyhound racecourses and the inability of off-course punters to bet into tracks' pools. Horseracing bookmakers represent a stronger competitive pressure and it would seem unlikely that pool betting deductions on horse racing could rise significantly above the current levels operated by the Tote. Against this background, the opportunities for extracting greater profit in a multiple-licence environment would seem limited, especially at the less popular racecourses.

57. Even without running the operation themselves, racecourse operators could charge operators greater rent if they are not tied to a single operator. At those racecourses that are sufficiently large to support dynamic pool betting operations, competition might improve customer service. This could attract higher attendances to those racecourses. The more popular racecourses and the multi-racecourse owners may benefit significantly from a multiple licence for pool betting.

58. To illustrate the potential profits of pool betting operations at the most popular race meetings, one can make some rough estimates for race meetings with an attendance in excess of 10,000. The average attendance at such race meetings was around 20,600 in 2002¹⁵. Consequently, the turnover of pool betting operations at a race meeting with an attendance in excess of 10,000 might be in the order of £300,000¹⁶. The total annual pool betting turnover at these race meetings could be in the order of £32 million¹⁷, producing gross profits of around £6.5 million¹⁸. If

¹⁵ Source: HBLB

¹⁶ If we scale up the average Win pool of about £10,000 in line with an attendance of 20,600, rather than 4,800 (average attendance), we have a theoretical average pool of about £42,900 per race, producing turnover of about £300,000 for a race meeting (assuming seven races per race meeting).

¹⁷ Assuming that there are 108 race meetings with attendance above 10,000, which is suggested by HBLB data for 2002.

¹⁸ Assuming that deductions are 20%.

multiple licences stimulate competition between pool betting operators, this may attract more punters and increase the size of the market.

Betting providers

59. If pool-betting operations ceased at some smaller race meetings or racecourses, this would remove a source of competition to fixed odds betting. This would benefit other betting providers. Margins are unlikely to be significantly affected, as competition between racecourse bookmakers is strong, suggesting that the loss of pool betting at these racecourses would be minimal

60. To illustrate the potential impact of losing on-course pool betting, one can also produced some rough estimates for race meetings with an attendance of less than 1,000. The average gross profit of pool-betting operations at a race meeting with an attendance of 1,000 might be in the order of £3,000¹⁹. Some 8.5% of race meetings (about 100 meetings in an average year) had an attendance of less than 1,000 in 2002 and an average attendance of about 700, which suggests gross turnover of about £10,000 per race meeting²⁰. If on-course pool betting operations were not viable with an attendance of less than 1,000, this suggests that about £1 million of turnover would be lost from the total on-course pool betting market. Such a turnover represents only about 0.2% of total on-course bookmaker turnover, but any impact would be much more significant for those bookmakers at racecourses where pool betting is no longer viable.

61. Larger bookmakers may gain opportunities to enter into pool betting, both on-course and off-course. They may be more interested in 'exotic' off-course products as they are less likely to cannibalise existing fixed odds demand. Bookmakers may be interested in the win and place pools for the more popular race meetings. The potential behaviour of the larger bookmakers in a liberalised pool betting market is highly uncertain. Nevertheless, any increase in bookmakers' turnover is likely to be offset by the reduction in Tote turnover.

Betting consumer

62. It cannot be taken for granted that increased competition in pool betting will reduce deductions significantly, if, as many people believe, pool betting is already in competition with fixed odds betting. However it cannot be discounted that new entry into pool betting may improve customer service and choice.

63. Some consumers would lose out if operations were closed at certain less popular race meetings. For example, if operations were to close at all meetings with an attendance of less than 1,000, some 100,000 punters could be affected. The impact may also be greater if there was less access from other racecourses and from betting shops.

¹⁹ If we scale down the average Win pool of about £10,000 in line with an attendance of 1,000 rather than 4,800 (average attendance), we have a theoretical average pool of about £2,100, producing gross profits of about £420 for a single race, or about £3,000 for a meeting (assuming seven races).

²⁰ The average turnover per pool is £10,000, which scale down for an attendance of 700, rather than 4,800, is about £1,450. With an average of seven races per meeting, this provides a turnover of about £10,000.

64. In the short to medium term, new competition could improve customer service and choice but would also reduce quality if pool sizes were smaller and reduce choice if some pool betting operations were forced to close. In the longer term, no more than one operator is likely to be present at most racecourses since pool betting has many of the characteristics of a natural monopoly. Consequently, there may be little long-term benefit for the consumer.

Taxpayer (Government)

65. The Government would receive sale proceeds, as described above. As for Option 2, if the performance of the Tote were to improve as a result of the sale and as a result of competition, then the taxpayer would benefit from increased receipts from Gross Profits Tax. If competition causes the pool betting market to grow there may be further benefits to taxpayers. Regulatory burdens would be lower than under Option 2, as there is less need for licence conditions (e.g. maximum deductions) to restrict the behaviour of the exclusive licensee. Government will benefit from any increases in efficiency and innovation.

Costs

66. As with the analysis of benefits, we use Option 1 as a base case against which to assess the incremental costs of Option 2 and Option 3.

Costs of Option 2: (Sale of the Tote with an exclusive licence)

67. There are few quantifiable costs of selling the Tote to a Racing Trust with an exclusive licence for pool betting, except for the costs associated with the sale.

The Tote

68. Any reduction in management costs, arising from increased commercial incentives for profit maximisation, would be likely to reduce employment, representing a cost for the staff of the Tote. The reduction in employment would be likely to be in line with the reduction in management costs. For example, a reduction of one quarter could involve the loss of 900 jobs.

Horseracing industry

69. The Racing Trust would assume responsibility for the debt arising from the sale and would also bear transaction costs, estimated by the Tote to be about £2-3 million²¹. The horseracing industry could suffer another cost under Option 2, as it would not be able to negotiate with competing pool operators to get a fair price for providing the opportunity to place pool bets. On the other hand, if racing owned the Tote it would share the benefits which are the other side of that coin.

Betting providers

70. If the sale were to create more competitive, dynamic Tote operations at racecourses, bookmakers would face more effective competition, which could reduce their turnover. The Tote would need to ensure that it did not leverage its temporary

²¹ Includes potential refinancing costs.

power in pool betting to the unfair competitive disadvantage of other commercial operators who cannot operate pool bets.

Betting consumers

71. If pool betting products share a market with fixed odds products (see Competition Assessment below), the Tote would not be able to exploit its position as the only provider of pool betting products by raising deductions. Hence, Option 2 does not represent a potential cost to consumers in terms of higher prices.

Taxpayer (Government)

72. The Government face some transaction costs arising from the sale of the Tote, estimated to be in the order of £1-2 million²². If licence conditions, such as maximum deductions or minimum service levels are imposed on the Tote then this increases regulatory costs for the Tote and Government.

Costs of Option 3: (Sale of the Tote without an exclusive licence)

The Tote and its staff

73. Without an exclusive licence for pool betting, competition could drive down the Tote's turnover both from on-course and off-course pool betting, as the Tote could lose pool betting market share. This would reduce the Tote's turnover, profitability and employment, although this would be offset by increases in turnover, profitability and employment by rival operators. The extent to which the Tote would be affected by the loss of its exclusive licence would be offset, in part, by any 'first mover advantage'.

74. The impact on Tote on-course pool betting would be more likely to fall on small operations. These might be forced to close. Meanwhile, operations at large race meetings and racecourses, such as those provided by the large independent multi-site operators, would face fierce potential competition. Pool betting represents 30% of total Tote turnover. Off-course pool betting and 'Win' pool betting at larger race meetings accounts for over a third of Tote pool betting turnover. On-course fixed odds betting represents about 4% of total Tote turnover. The loss of pool betting could also have a wider impact on the Tote brand. If both pool-betting and on-course fixed odds betting are affected by multiple licenses, this will affect areas that account for 34% of the Tote's turnover. However, improved efficiency from competition may counterbalance this by increasing profits.

75. Loss of turnover would be likely to have a proportional impact on Tote employment, on top of any reduction in employment arising from improved efficiency (see Paragraph 82). Loss of turnover from 'Win' pool betting at the larger race meetings and 'exotic' pool betting, combined with a one quarter reduction in management costs, could reduce employment by around a third²³.

Horseracing industry

²² Source: DCMS

²³ Source: PwC estimate

76. Currently, the Tote makes substantial contributions to the horse racing industry in the form of payments to the Levy Board (although these are changing to payments for the data and audio-visual rights necessary to take bets), payments to racecourses and sponsorship of race meetings. If competitive pressure in a pool betting environment without an exclusive licence drove down net profits, this could result in reduced *discretionary* payments²⁴. This reduction would only be partly offset by increases in payments made by other bookmakers, including sponsorship paid for commercial reasons. Some of the Tote's sponsorship payments are made for commercial reasons, but the relatively high level of sponsorship suggests, however, that it is discretionary in part.

77. The Tote's contribution to racing in 2001/2002 was £14.7 million in 2001/2. Any change in its net profits would be likely to have a proportional impact on future contributions. The impact of a change of turnover due to loss of market share on net profits is ambiguous as the closure of loss-making pool betting operations would boost net profits while any loss of revenue due to competition at the larger, more profitable race meetings would have a negative impact on net profits.

78. The racing industry would also receive lower funds if pool betting operations were closed at certain race meetings or racecourses since it would lead to smaller payments to racecourses and lower attendances as punters reacted to the reduced range of betting opportunities. Much of this expenditure would be redirected to on-course fixed odds betting as increased turnover, so the Tote may be able to recover this through its fixed-odds business. Any improvement in efficiency of the Tote's operation may improve profitability, even if turnover is lower.

79. The Racing Trust would also assume responsibility for the debt arising from the sale, as well as transaction costs.

Betting providers

80. If increased competition were to create more competitive, dynamic pool betting operations at racecourses, bookmakers would face more intense competition. This could reduce their net profits if they lost market share. This impact is not likely, however, to be any greater than that envisaged under Option 2.

Betting consumer

81. The closure of pool betting operations at certain race meetings would reduce consumer choice at racecourses where it is inefficient for the Tote to operate, although this will remove the cross-subsidies and therefore benefit other consumers. The loss of turnover from pool betting closure discussed in the illustrative example above is around £1 million per annum, affecting perhaps 100,000 punters, although most of this expenditure would be expected to shift to fixed odds betting. The severity of the impact on consumer welfare depends upon how distinct pool betting is from fixed odds betting.

Taxpayer (Government)

²⁴ Payments that are not required by Racing and are not made for commercial profit-maximising reasons. Some sponsorship payments may be made for commercial reasons as a form of advertisement.

82. Increased competition in pool betting is likely to be broadly tax neutral. The Government also face some transaction costs arising from the sale of the Tote of around £1- £2million.

Consultation with small business

83. Small businesses were consulted as part of the Government's general consultation on future licensing of pool betting on horseracing²⁵. Small businesses responded to the consultation. Racecourse bookmakers concentrated their comments on their own ability to compete with the Tote in all areas of the racecourse (at the moment they may only operate in a restricted 'betting ring'). Independent racecourses responded as part of the Racecourse Association response, and did not note opposition to the proposal to sell the Tote to a Racing Trust. During the development of this RIA, further discussions were held with the National Association of Bookmakers, who confirmed their views.

Competition Assessment

Market definition

84. The market directly affected by the policy options under consideration is the market that includes pool betting on horse races in Britain. The exact definition of the *relevant* market to consider in relation to pool betting is key to the competition assessment for the options under consideration. Following consultation with the stakeholders noted above and the Office of Fair Trading (OFT), and analysis conducted by PWC on behalf of the Department, it is evident that there is no consensus on the definition of the relevant market.

85. There are a number of areas of evidence to support the view that the relevant market is that for all betting on British horseracing in Britain, including both pool betting and fixed odds betting, but not including betting on other sports and number draws.

- First, there is sufficient price transparency to allow punters to judge relative returns (dividends/prize payments) from pool betting and fixed odds betting, either before a race – by comparing 'Will Pays'²⁶ and 'Board Prices'²⁷ that provide an indication of *expected* returns – or after the race – by comparing actual Tote dividends and bookmaker payouts²⁸. There is also considerable

²⁵ Consultation paper on the abolition of the Levy Board and the licensing of racecourse betting and pool betting on horseracing: Home Office: November 2000

²⁶ The Tote produce 'Will Pays' while bets are being taken. They measure the equivalent fixed odds that the pool would currently pay out. The 'Will Pays' change as bets are placed, as they affect the size of the pool and the relative weight of different bets.

²⁷ 'Board Prices' are the fixed odds that racecourse bookmakers are offering at a moment in time before the end of betting is called (at which point the 'Board Prices' become the 'Starting Prices'). 'Starting Prices' determine the odds at off-course betting shops for some 68% of horseracing bets, according to the MMC report.

²⁸ Off-course punters using Tote Direct (except at Tote betting shops) are not provided with Tote 'Will Pays' before the race, and are therefore only able to compare returns after the race. This affects about a third of Tote pool betting turnover.

public information available about the relative returns of different forms of betting on horseracing²⁹.

- Secondly, whilst a proportion of punters do not consider differences in returns between different betting products, this does not preclude pool betting and fixed odds betting being part of the same market. It is not necessary for all punters to switch readily between products in response to a small, significant price change in order for there to be effective competition between the products, as long as enough *marginal* consumers do switch. For example, at high profile races with large fields, where the pool tends to be larger (and therefore provides better value, particularly on non-favourites), experience suggests that expert punters are more likely to bet with the Tote.
- Finally, bookmakers' attitudes towards pool betting suggest that they consider it to be in competition with their fixed odds betting products. Although bookmakers are able to offer Tote pools in their high street shops through the Tote Direct network, of the big three bookmakers only two have chosen to do so. The only major bookmaker with no Tote Direct terminals instead accepts bets at Tote odds. Moreover, bookmakers' promotional efforts focus on the more 'exotic' pool bets rather than those that are closer substitutes with their fixed odds products. In relation to the win and place pools, bookmakers consider themselves to be in competition with pool betting.

86. However, in 1998, the Monopolies and Mergers Commission (MMC)³⁰ concluded that:

“while regular punters were likely to be aware of the relative returns from fixed odds and pool betting...most punters restricted themselves to one or other form of betting as a matter of preference and habit. It seems unlikely that small changes in the price of pool betting or of fixed odds would change the pattern of use very much, and hence there is scope for exploiting the one type of betting separate from the other. We therefore consider that...the preferences of punters clearly distinguishes between...[pool and fixed odds betting], and hence pool betting is...best seen as a distinct segment of the betting market”.

87. More recently, other research has argued that pool betting on British horseracing in Great Britain is itself a *relevant* market for determining market power since it represents a distinct product market, separate from other forms of horserace betting. Consumers are unlikely to switch to other products in response to small, significant changes in the price of pool bets and, therefore, the Tote does not face significant competition from other forms of horserace betting. Off-course the most popular pool bets are exotics whose characteristics may differ from those of fixed-odds bets.

88. The evidence researchers have gathered suggests that punters are unable to judge easily the 'price' of a bet. Almost all off-course punters cannot observe 'Will

²⁹ For instance in publications such as Racing Post or from commentators on TV horseracing programmes.

³⁰ Source: “Ladbrokes Group Plc and the Coral betting business”, MMC September 1998, Cm4030, paragraph 2.65

Pays'. 'Will Pays' can change. Punters may not know what the starting price odds will be at the time they place a bet. Punters must, therefore, form a judgment about the likely odds. It is more difficult for punters to judge the relative value of the two types of betting with the result that there is less possibility of switching in response to price differences.

89. Some commentators have suggested that most punters do not compare 'prices' before or after a race. They suggest that the convenience of Tote betting (with its presence in 90% of public areas at racecourses) is a more significant factor on course.

90. As noted above, punters may assess their average level of returns over the *medium term*. This can only happen if punters learn what average returns are. There appears to be a widely held misperception that the Tote offers worse value, even when this is not the case. This implies that punters have difficulties in learning average returns, even when given time to do so.

91. Tote deductions vary significantly between different pool bets. This may be evidence that the Tote has already raised prices above the competitive level. Fixed odds betting providers face different costs, and a competitive market in pool bets would allow these to be priced at a lower level.

Current nature of competition

92. There is considerable competition in horse race betting, particularly on-course. Competition off-course is more restrained, although the use of Board Prices and Starting Prices keeps prices at the level determined by on-course bookmakers. According to HBLB data for 54 of the 59 British racecourses in 2002, there was on average 44 bookmakers at each race meeting often competing directly in the 'ring'. This suggests *prima facie* evidence that competition is intense and this is supported by the relatively low margins earned by bookmakers from horserace betting (based on Starting Prices) compared to other forms of betting.

93. Board Prices and Starting Prices determine the vast majority of off-course horse race bets, so that competition off-course is not important in terms of the price³¹. In general, competition is limited by the location of betting shops since convenience is an important aspect of choice besides price. The development of Internet, telephone betting and betting exchanges, however, make it easier for punters to compare prices between bookmakers and exploit differences where they exist. There is currently no direct competition to the Tote in the supply of pool bets on horse races.

Potential impact on competition of a sale of the Tote to a Racing Trust

94. It has been argued that the sale of the Tote to a Racing Trust could create competition concerns if the relationships between the Tote, the horse racing industry's regulatory organisations and the providers of horse racing were deepened. These organisations would have an incentive to favour the Tote over and above other bookmakers if they were part of a Trust.

³¹ Off-course bookmakers do influence Board Prices and Starting Prices by placing bets with on-course bookmakers to 'lay-off' their risk on certain horses. This behaviour does not tend to influence the average margins provided by Board Prices and Starting Prices, however.

95. The proposed structure of the Racing Trust is, however, designed to reduce these risks by giving control to a broad range of racing interests. Furthermore, the racing industry may have little *additional* reason to favour the Tote, as it is already the beneficiary of the profits made by the Tote.

Potential impact on competition of exclusive versus multiple licences

96. As larger pools are inherently more profitable than smaller pools, one might expect a long term trend towards there being only a single on-course pool operator on most races. At larger race meetings, however, demand may be sufficient to support more than one pool operator, but even here there would be advantages to operating a single pool in terms of both cost and quality of the pool. The removal of the exclusive licence from the Tote may, therefore, create an initial period of competition, with more than one pool operating initially at race meetings but, over time, competition would be expected to lead to amalgamation until there is only one operator at each meeting, albeit with the possibility of different deductions being made by each operator.

97. A single long-term operator at a particular racecourse need not be the Tote, however, as large betting operators, perhaps in conjunction with racecourse owners, would be in a position to offer a highly competitive alternative. Racecourses are likely to select the Tote if it provides significant contributions to racing. The large off-course networks of the large betting operators could be utilised to provide significant off-course and course-to-course revenue into on-course pools.

98. Competition developments in the off-course pool betting market, without the current exclusive licence, could be different. If competition between off-course 'exotic' pool betting products and fixed odds products were less intense than with on-course pool betting products, then interest among other betting providers could be greater as there would be less risk of cannibalising demand from their other products. With sufficient promotion and by allowing other bookmakers to provide the pool betting product (as Tote Direct does at present), a larger betting operator might be able to create sufficient demand to run a successful 'exotic' pool betting product without requiring any on-course presence.

99. Overall, regardless of the market definition adopted, competition will be stronger under Option 3, with multiple licences, than with the other options. The removal of the exclusive licence for pool betting may result in some small racecourses no longer offering pool betting, since it may be inefficient for them to do so.

Enforcement and sanctions

100. The proposal involves no specific arrangements for enforcement or sanctions. Proposals in the draft Gambling Bill for the licensing of pool betting on horseracing by the Gambling Commission will address the content and conditions of licences, and any penalties for breaches of those conditions.

Monitoring and review

101. The Bill will provide for the Gaming Board to revoke the exclusive licence if the conditions of the licence are not observed. In addition, proposals for a Gambling

Commission in the draft Gambling Bill will address how it will monitor and review gambling licensees, and how it might advise the Secretary of State on the number of licences to be issued for pool betting on horseracing.

Consultation

Within Government

102. All Government Departments have been consulted in the development of proposals, including the Office of Fair Trading. The Department has also consulted the Scottish Executive, the Totalisator Board and the Horserace Betting Levy Board.

Public consultation

103. Following the publication of the Tote Steering Group review in May 1999, there was considerable discussion of the future of the Tote within the horseracing industry. As a consequence, the Department (then the Home Office) received proposals from industry representatives (notably the Tote itself, the British Horseracing Board and the Racecourse Association and others) for a racing trust that would purchase the Tote from the Government.

104. The Government undertook a consultation exercise on its plans for the reform of its involvement in horseracing in November 2000. ('Consultation paper on the abolition of the Levy Board and the licensing of racecourse betting and pool betting on horseracing: Home Office'). This paper built on the conclusions of the Tote review. There were 40 detailed responses to the November 2000 consultation. There was strong support from within racing for the sale of the Tote to a racing trust and the retention by the Tote of an exclusive pool betting licence. Bookmakers opposed the sale strategy proposed and instead advocated an open market sale and also recommended that pool betting be opened up to competition after a short transitional period.

105. Further consultation was undertaken during the development of this RIA. Interviews were held with:

- Association of British Bookmakers (ABB)
- British Horseracing Board (BHB)
- National Association of Bookmakers (NAB)
- Northern Racing Ltd
- Office of Fair Trading (OFT)
- Racecourse Association (RCA)
- The Tote

Summary and recommendation

106. The most significant costs and benefits of the policy options under consideration, relative to the status quo (Option 1) are summarised in the table below.

	Option 2 <i>(with an exclusive licence)</i>	Option 3 <i>(without an exclusive licence)</i>
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Benefits	1) Improved certainty and commercial performance of the Tote 2) The Tote gain improved access to private finance 3) Potentially higher Tote contributions to Racing 4) Sale proceeds to the Government	1) Improved commercial performance of the Tote and rationalising operations 2) Opportunities for racecourse owners to provide pool betting products 3) Opportunities for bookmakers to provide pool betting products and gains from loss of competition from the Tote at some race meetings 4) Sale proceeds to the Government 5) Increased competition in horse-race betting 6) Increased data and AV rights funding for racing from the rival pool operators. 7) The Tote gain improved access to private finance 8) Increased employment by new pool betting operators (corollary of cost 3)
Costs	1) Cost to the Tote of the sale price 2) Transaction costs for both the Tote and Government 3) Opportunity cost for potential pool betting operators 4) Potential higher regulatory burdens for Tote and Government from more complex licence conditions	1) Cost to the Tote of the sale price 2) Transaction costs for both the Tote and Government 3) Tote cuts employment due to loss of market share 4) Lower Tote contributions to Racing 5) Possible loss of pool betting at some race meetings/racecourses

107. The Government's sale strategy focuses upon five objectives. The summary of costs and benefits above indicates that these objectives would be achieved by the Government preferred option, Option 2. (The sale of the Tote and its operation as a private company with a time-limited exclusive licence for pool betting on British horseracing). This is the Government's recommendation.

108. It is apparent from the table above that the principal alternative, sale with a non-exclusive licence, would have benefits for a number of the business sectors affected, most notably alternative operators of pool betting, punters and bookmakers. It is also conceivable that the removal of the exclusive licence would not result in a widespread withdrawal of pool betting services. There would certainly be a number

of companies in Great Britain, let alone other countries, with the necessary experience of horserace betting and finance available to meet start up costs. It is also inevitable that the introduction of more operators would bring some benefits for consumers in the form of product innovation and price competition, although there may also be a risk of further consolidation in a betting market already dominated by a relatively small number of large bookmaking companies, with substantial chains of betting offices.

109. However, in considering the options for the sale and for licensing it is important to underline that the Government's objectives for the sale go beyond the level of proceeds and the efficient regulation of pool betting operators. The Government sees value in the relationship between the Tote and horseracing that has been in place since its creation. In simple terms, the Government does not see the Tote as just one more betting company. Its particular role can be seen most clearly in relation to its voluntary contribution to racing. Other than those required for reinvestment (and acquisitions), the Tote's profits are directed to support horseracing. In 2001-2002 its profits were £17.5 million, of which £14.7 million found its way to horseracing. This figure includes its payments to the Levy Board and those that could be construed as rent to racecourses. But even after generous allowance for these, its overall contribution is considerably in excess of that which a bookmaker would make through standard levy payments.

110. By historical standards, horseracing is doing quite well at the moment, due to the change in betting taxation and payments for its data and pictures. In comparison, the Tote's contribution is relatively modest. But it has been a consistent feature of the industry for a number of years, to the extent that many people refer to the Tote as 'racing's bookmaker'. Without the exclusive licence the Tote would be more likely to behave like a normal competitive company.

111. The Tote also performs a public service role in relation to its services at racecourses. Its operations could no doubt be conducted in a less staff intensive fashion, and through fewer betting points. It might also make higher profits by providing only a skeleton service at less profitable courses. But the Tote sees comprehensive service as one of its defining aims. The Government sees value in this ethos.

112. For these reasons, the Government proposes that the Tote be sold to a racing trust, and enjoy a time limited exclusive licence for pool betting on British horseracing.

B: ABOLITION OF THE HORSERACE BETTING LEVY BOARD: REGULATORY IMPACT ASSESSMENT

Purpose and intended effect

1. The purpose of the measure is to abolish the Horserace Betting Levy Board (HBLB).
2. The intended effect of the measure is to allow for the future funding of horseracing to be secured through commercial agreements between the horseracing industry and betting companies. Bookmakers will make payments to horseracing for pre-race data that enables them to offer bets on horseracing and for television pictures of races.

Devolution

3. The measure extends to Great Britain.

Background

4. The HBLB is a statutory body administered under the Betting, Gaming and Lotteries Act 1963. It is charged with the duty of assessing and collecting monetary contributions from bookmakers and the Horserace Totalisator Board (The Tote), and with applying them for purposes conducive to one or more of:

- the improvement of breeds of horses;
- the advancement or encouragement of veterinary science or veterinary education; and
- the improvement of horseracing.

5. In 2001/02 the Levy Board received £67 million from the bookmakers' levy scheme, and £5.1 million from the Tote. Levy funds were spent in 2001-2002 in the following way:

(£,000)

Prize Money	38,687	48%
Integrity Services	18,023	24%
Other racecourse expenditure	10,798	14%
Administration	2,994	4%
Veterinary	1,448	2%
Improvement of breeds	1,555	2%
Training	427	1%
Other improvements	3,801	5%
Bookmakers' Committee	229	0%
TOTAL	74,962	

6. The Board is also responsible for the stewardship of the National Stud, a commercial breeding operation, and HFL Ltd. (formerly the Horseracing Forensic Laboratory Ltd), whose principal activity is the provision of a research-backed equine drug screening service. The Board also issues certificates of approval to horse racecourses. These certificates are a form of licensing, limited in scope to betting matters (the provision of on-course space for bookmakers, and their admission at reasonable charge).

7. In anticipation of the Board's abolition, the horseracing and betting industries have already developed a more commercial relationship. Payments have been agreed for the provision of television pictures of races. In 2002 these payments were expected to total around £25million. Moreover, in reaching agreements on the level of the statutory levy, both sides of the industry are already taking into account the costs of pre-race data agreed with the British Horseracing Board. Payments for data are now offset against levy payments. In essence, bookmakers already make payments for data through the levy system.

Risk assessment

8. The measure is concerned with two risks. These are most sensibly described in terms of the positive outcomes associated with their avoidance:

- horseracing to continue to exist as a successful sport operated at the highest standards of integrity, breeding and veterinary care; and
- horserace betting to be one part of a successful UK gambling industry.

Business sectors affected

9. The business sectors affected are the horseracing industry and betting companies taking bets on British horseracing.

Horseracing

10. There are 59 horse racecourses in Great Britain. There are three large groups: Northern Racing Ltd manage 9 courses; Arena Leisure PLC manage 6 and The Jockey Club (through their subsidiary, Racecourse Holdings Trust) own 13 courses. The remaining courses, with one exception, are owned independently. The horseracing and associated breeding industry supports approximately 60,000 jobs in Britain, and it is a significant employer in rural areas.

11. In 2002, there were 7,691 races during 1,158 fixtures. A total of 5,557,758 persons attended horse races. Over the year, an average of 13,182 horses were in training, owned by approximately 9,000 individuals, partnerships and companies. Total prize money was £84.2 million. The HBLB contributed 46.8% of this total. The remainder came from sponsors (37.5%), owners (14.1%) and other sources (1.5%).

Betting companies

12. The betting industry employs approximately 40,000 people across Great Britain. Bookmakers operate at horse race courses, through licensed betting offices and through telephone and Internet services. In 2000, there were approximately 8,750 betting offices across Great Britain and 3,800 bookmakers' permits in force. There are a number of companies in the market with large market shares (William Hills, Corals, Ladbrokes, Stanley Racing and the Tote) but also a proliferation of smaller regional betting office chains and a considerable number of one-person enterprises (mostly bookmakers standing at racecourses). A number of companies, known as betting exchanges, also offer services over the Internet where consumers can accept and offer bets on horseracing. The largest of these companies is 'Betfair'. There are also a number of companies offering products known as spread betting.

13. The HBLB estimate that betting on British horseracing will generate approximately £975million of gross profits for betting companies during 2003-2004, 54% of their total profits. In 2001 (when there was a change in the tax regime from a turnover to a profits tax) general betting duty raised £474million. As noted above, the principal relationship between horseracing and the betting industry is through payments to the former from the latter for the provision of pre-race data and television pictures of horseracing. The betting industry is also a major sponsor of horseracing events. Since the abolition of general betting duty, there has been a significant increase in betting turnover of around 35-40%. In turn, betting companies are paying significantly more to the racing industry. Overall income by 2004 is likely to be double what it was in 2001.

Issues of equity and fairness

14. The proposal is not intended to address a current inequality and will not introduce any new inequality. Rather, the proposal is intended to permit the negotiation and agreement of a market price for the racing product.

Options

15. There are two options:

- Option 1: **Do nothing**. This would involve the continuation of the statutory levy system.
- Option 2: **Abolish the Horserace Betting Levy Board**. The subsidiary functions and assets of the Levy Board would also be transferred to racing bodies, including the BHB, at nil cost and would operate on similar terms.

16. Options 1 and 2 both involve the continuation of HBLB's subsidiary functions (the Horserace Forensic Laboratory, the National Stud and the fund for racecourse improvement). Option 2 involves the continuation of these activities by racing bodies, including the British Horseracing Board. In addition, the options noted do not include any consideration of options for the Levy Board's present responsibilities for the licensing of betting areas at racecourses. These matters are not addressed in these proposals. They will be included in Government proposals for a Gambling Commission.

Benefits

Option 1: (Do nothing)

17. Continuation of the statutory levy system would have benefits for bookmakers, smaller bookmakers in particular and the staff of the Levy Board.

Bookmakers

18. Smaller bookmakers derive a particular benefit from the two-tier structure in the levy system. Levy agreements have traditionally made special arrangements for bookmakers with smaller operations, including those who operate at racecourses. In the 42nd scheme betting shops with a gross profit on horseracing of less than £75k per year will pay a rebated charge related to the percentage by which their gross profits fall short of £75k, subject to a minimum payment of £2000 per shop. Bookmakers operating at racecourses also benefit from a system of rebates where those with profits below £75k pay a reduced rate, subject to the same minimum. The Levy Board estimate that approximately 2300 operators will benefit from these rebated payments and will contribute approximately £4.6m to the levy scheme. Had their contributions been collected on the same basis as larger bookmakers, the total cost would have been approximately £11.5m. It is important to note, however, that the licensing regime established for the sale of data rights, by the BHB) has recognised the position of smaller bookmakers and continued a system of reduced payments.

Levy Board staff

19. Maintenance of the levy system would have a benefit for the staff of the Levy Board, in terms of continuing employment. On its abolition, it is envisaged that almost all of the 25 administrative staff will be made redundant. Wages and salaries for the Levy Board in 2002 (excluding pension costs and employers' NI contributions) were £0.925m.

Option 2: (Abolish the Horserace Betting Levy Board)

20. The benefits of abolition will accrue to the horseracing industry, bookmakers and the Government.

Horseracing industry

21. The principal benefit of abolishing the statutory levy is the ability of the horseracing industry to seek a commercial price for one of its products (race information). The levy was never intended to be a market price. The Bookmakers' Committee devises a scheme on the basis of their assessment of the needs of horseracing, balanced against bookmakers' ability to pay. Future proceeds to racing through payments for race data will flow from commercial negotiations, and are therefore impossible to predict.

22. Notwithstanding this, the BHB and the bookmakers have agreed that payments made by bookmakers can be offset against their liabilities in respect of levy payments. To a limited extent, the levy procedures are already operating as a proxy for a commercial negotiation process. Prior to data licence negotiations (40th scheme) levy

yield was £67million. The Levy Board estimate (on the basis of profit projections) that the 41st scheme will raise £86million and the 42nd £94 million. These benefits have already been realised, so could not be said to be a specific benefit of abolition. The introduction of profits based taxation has been a major factor in enhancing betting turnover and profitability, and the consequent funding of racing. Nonetheless, the increase in annual yield (£27 million) over the period can to some extent be attributed to the preliminary stages of fully commercial relationships.

Bookmakers

23. The abolition of the Levy Board will also save bookmakers the administrative costs involved in its negotiation and collection. In 2001/2002, expenditure on Levy Board administration (including the Bookmaker's Committee) came to £3.2 million. Administration costs are paid for out of levy income and are therefore a cost to bookmakers.

Government

24. The abolition of the statutory levy will have benefits for the Government. Commercial payments will generate VAT receipts. The 42nd levy scheme is projected to yield approximately £94million. Were these payments to be made commercially, there would be a VAT charge of £16.4million. In addition, in the event that the Levy Board and the Bookmakers' Committee are unable to reach agreement on a levy, the Government is required to determine the scheme. These costs fall on the Levy Board. In 2001, a determination was necessary and the cost was £47,000.

Costs/Risks

Option 1:

25. The costs and risks of maintaining the levy system fall upon the Government, bookmakers and the horseracing industry. The Government will continue to be required to determine the levy scheme where the Bookmaker's Committee fails to reach agreement. Bookmakers will continue to pay for the administration of the Levy Board. The horseracing industry will forgo the additional income that might be secured via fully commercial agreements for its pre-race data.

Option 2:

26. The costs and risks of abolishing the levy system fall upon the horseracing industry and bookmakers. These risks are in part mutually exclusive and relate to commercial payments and the costs and outcome of negotiations.

27. As noted above, payments will be subject to VAT that would fall proportionately on all bookmakers.

28. Abolition of the levy system would involve a risk of lengthy and costly commercial negotiations. In 2001/2002, the costs of the Bookmakers' Committee were £229k. The Government takes no view on the appropriate structures for future commercial negotiations. It does seem likely that, subject to competition

considerations, the industries will continue to negotiate through trade associations and governing bodies, or perhaps as smaller groups of suppliers and purchasers, but one cannot rule out the additional costs that might flow from negotiations between individual betting companies and the sellers of data. Whilst impossible to quantify at this point, any costs would be borne by bookmakers and the horseracing industry. There will also be administration costs associated with payment systems.

Outcome of negotiations – potential costs for horseracing or betting

29. British horseracing and betting can be seen to exist in a symbiotic relationship. It is not in the interests of either to price the other out of existence. In time, however, either side of the relationship (and/or different parts of each) may very well take a less inclusive view of shared interests, and accordingly adopt a more aggressive negotiating posture. This would lead to negative consequences for the ‘loser’ in the negotiation.

Horseracing

30. Commercial negotiations may lead to a reduction in the amount of money being raised to support horseracing. This might lead to some of the following impacts:

- Insufficient finance might lead to the closure of unprofitable racecourses or a decrease in the number of fixtures.
- The supply of horses for racing might also be reduced if less prize money was made available (including more horse owners being attracted to races overseas by the prospect of higher rewards). This would be dependent on the willingness and ease with which owners could switch their horses to foreign races.
- There might also be a reduction in the quality of horseracing available as a consequence of lower investment in horse breeding and fewer foreign horse owners being attracted to British races and British horses racing overseas.
- Attendances at horse races might fall if racecourse facilities are not maintained or improved to keep pace with consumer expectations. If that were the case, consumers may switch to other leisure opportunities. The popularity of horseracing might also suffer were there a perception that the integrity of races were endangered by lower investment in the technical services, like camera patrol and photo finish equipment.

31. The table below note comparative data for prize money and profitability of horse ownership between Great Britain and a number of its principal competitors, in 2001. In some cases, the figures do not compare exactly. For example, in the case of Australia, the average includes prize money for their equivalent of point-to-point races. They should therefore be seen as an illustration rather than a precise analysis.

Country	Average prize money per race (Euros)	% Running costs covered by prize money
Great Britain	16,080	23
France	16,310	54
Republic of Ireland	21,810	27

Australia	4,160	42
South Africa	4,140	51
United States	13,000	53
Japan	36,810	78
Hong Kong	140,930	139

32. Britain is clearly in the top division of international horseracing, but there are alternative venues for racehorses. Owners and horses are also mobile, despite the costs involved in transportation and accommodation. For example, during 2002, horses trained in Great Britain competing abroad won £10.71m (which was equivalent to 12.7% of the total prize money available in Great Britain that year). In addition, prize money won in Great Britain by horses trained overseas totaled £5.52m, or 6.5% of the total available. There is therefore considerable inflow and outflow of competing horses.

33. Costs arising from lower income are impossible to predict. They would be borne (in the first instance) by the owners of horse racecourses and their employees, and the owners of horses and their employees. As horse racecourses tend to be in more rural areas, these areas would be disproportionately affected by reductions in employment and other economic impacts. A reduction in horserace income could lead to the closure of one or more course. If a medium sized racecourse were to close one might see the loss of approximately 90-100 direct jobs, as well as jobs in betting services and breeding activities that were not able to relocate to other courses. Closures would also lead to a loss of non-race day income (e.g. conference services) to the local economy.

Betting industry

34. The second (and opposite) risk associated with the abolition of the statutory levy is that commercial negotiation might result in significantly higher costs for the betting industry, or some of its parts.

35. Were the cost of providing horserace betting to increase, companies could offer alternative products. Betting on British horseracing now accounts for approximately 54% of betting profits (and foreign horseracing 5%). The remaining 41% is made up of greyhound racing, numbers and machine betting and football and other sports' betting. It is not clear to what extent consumers might be open to switching away from horseracing. The decreasing proportion of bets staked on horses does suggest that there is a market for alternative products, but it is difficult to make any more certain predictions about likely consumer reactions, and the consequent position of betting providers. During the 2001 outbreak of foot and mouth disease, which caused a number of race meetings to be cancelled, the main bookmaking companies experienced a reduction in revenue. An industry data sample suggests that turnover on British horserace betting in the shops fell by over 50% during March 2001, which was the most severe period of restrictions; but the average fall on all horserace turnover was around 46%, reflecting the ameliorating effects of demand for foreign racing.

36. If betting companies decided to absorb increased costs in providing horserace betting, and instead looked to economies elsewhere in their business, they might seek to reduce the number of betting shops (with their associated staff costs). Industry representatives estimate that increase in costs of £10,000 per betting shop might cause about 450 shops to become unprofitable. If across the betting industry, the increase in costs were somewhat less, and resulted in the closure of 100 offices, the reduction in direct employment might total approximately 350 jobs, and a reduction in household incomes of approximately £4.5 million per annum, not including posts that might also be lost in central support functions or any knock-on effects for businesses operating in the locality of betting shops, and depending on passing trade from their customers.

37. With respect to racecourse bookmakers, it is conceivable that increased costs might cause some to cease trading. At this point, it is impossible to estimate what number may be so affected, nor whether a reduction in numbers of suppliers might have a material impact on the intensity of competition between suppliers.

Consultation with small business

38. Small businesses were consulted as part of the Government's general consultation on the future of the levy system, in November 2000. Smaller bookmakers made a joint response with other bookmaker organisations through the Bookmaker's Committee. The joint response opposed the abolition of the Levy Board. DCMS continue to hold regular liaison meetings with these bodies.

Competition assessment

39. The markets affected by the measure are the horseracing industry and the part of the betting market concerned with betting on horse races in Britain. The measure proposed has no necessary impact on the intensity of competition between betting providers or providers of horseracing.

40. In the betting industry a number of larger firms have market shares in excess of 20%, and the three largest firms together (William Hill, Ladbrokes and Corals) have more than 50% market share. Amongst horseracing providers, the top three companies (the Racecourse Holdings Trust, Northern Racing and Arena Leisure) own less than half of the 59 British horse racecourses.

41. In broad terms, the market is not one characterised by rapid technological change. The principal features of the horseracing and betting products have remained consistent, although there is now greater scope for betting via the telephone and through other remote technologies.

42. The measure has no impact on the outcome of commercial negotiations and therefore has no different impact on different types of firms, whether bookmakers or racecourses. Nor will it lead to higher set up or ongoing costs for new companies. The measure has no effect upon the ways in which operators may choose the price, quality, range or location of their products.

Enforcement and sanctions

43. The proposal involves no arrangements for enforcement or sanctions.

Monitoring and review

44. The proposal involves no arrangements for monitoring or review.

Consultation

Within Government

45. All Government Departments have been consulted in the preparation and agreement of proposals. The Department has also consulted The Scottish Executive and the Horserace Betting Levy Board.

Public consultation

46. The Government has undertaken two consultation exercises to consider whether a statutory system for the funding of horseracing is necessary. These were:

- Prior Options Study: Quinquennial Review of the Levy Board: Home Office: March 2000
- Consultation paper on the abolition of the Levy Board and the licensing of racecourse betting and pool betting on horseracing: Home Office: November 2000

47. The prior options study set out a number of options for continuing achievement of the Levy Board's objectives, and concluded that there was no overriding reason why a public body and a statutory levy was required to achieve them. The Government therefore recommended (in the November 2000 paper) the abolition of the levy system and a move to a fully commercial funding solution for horseracing that would involve the sale of pre race information and television pictures of races to the bookmaking companies.

48. Forty detailed responses were received to the November 2000 consultation. Most supported the proposal to abolish the levy system, with the exception of a number of bookmaking companies who favoured retention. The majority of responses reflected a confidence that commercial negotiations would be successful in raising sufficient finance for horseracing. There was also strong support for continuing existing levels of expenditure on integrity services (e.g. technology to decide the winner of a race, and forensic technology to ensure that horses are not interfered with), veterinary services and breeding.

Summary and recommendation

49. The possible costs and benefits of abolishing the Horserace Betting Levy Board might be summarized as follows. Only some of these items are quantifiable, and some are mutually exclusive.

	Status quo	Abolition
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Benefits	1) Lower payments for smaller bookmakers (approx £7.1m per annum) 2) Income for Levy Board staff through employment (approx £0.925 per annum) Total estimated benefits: £8m	1) Saving on Levy Board administration (approx £3.2 million per annum) 2) Saving in avoiding costs of levy determination (approx £50,000 per annum) 3) Additional VAT receipts (estimate £16.4m) Total estimated benefits: £19.6m
Costs	1) Levy Board administration (approx £3.2m) 2) Costs of levy determination (estimate £50,000) Total estimated costs: £3.2m	1) Reduction in quality and quantity of horseracing, and risk of racecourse closure (estimate at Para 33), or ; Reduction in the profitability of betting on horseracing and risk of closure of betting shops (estimate at Para 36) 2) Additional VAT for bookmakers (estimate £16.4m) 3) Costs of commercial negotiations Total estimated costs: Minimum of £16.4m

50. The Government **recommends Option 2: Abolish the Horserace Betting Levy Board.**

51. Maintenance of the status quo (Option 1) would, of course, bring with it continuing benefits for both racing and bookmaking. This reflects, in part, the very effective manner in which the Levy Board has fulfilled its statutory responsibilities, and as a consequence has improved horseracing, horse breeding and veterinary science and education. Were it to continue in operation it would no doubt continue to perform well, and bring about further benefits.

52. Option 2 involves negotiations that could be contentious and expensive. It is, of course, quite possible that the dynamics of the negotiations might have negative impacts for the horseracing or bookmaking industries. Closed racecourses or betting shops are extreme possibilities, highlighted for their illustrative impact. The full benefits of abolition (beyond the saving of administrative costs) are necessarily uncertain. But, looking afresh at the issue it is difficult to identify a persuasive rationale for the Government to retain any statutory responsibility for, in effect, setting an annual fee for the use by one industry of another industry's product. Bookmakers and the racing industry have shown themselves capable of reaching mutually acceptable agreements on the dissemination of television pictures for races and the licensing of data use. With these developments in mind, the Government has concluded that it can now safely remove itself from the setting of prices.

C: OLYMPIC LOTTERY GAMES: REGULATORY IMPACT ASSESSMENT

Purpose and intended effect

(i) The Objective

1. The purpose of the Bill is to enable the establishment of hypothecated Olympic Lottery games, an Olympic Lottery Fund for holding proceeds of those games, and a mechanism for distributing Olympic Lottery money to meet expenditure in connection with the staging of the 2012 Games in the UK. These measures will generate a revenue stream to meet a proportion of the 2012 Olympics and Paralympics staging costs in the United Kingdom in the event of a successful London Bid.

2. The introduction of the measures are expected to have a diversionary impact on the revenue that existing Lottery good causes might receive between 2005 and 2012. This document sets out current estimates of how much is expected to be raised through hypothecated Olympic Lottery Games and seeks to assess the impact on the existing good causes during that time.

(ii) Background

3. The Government announced its intention to support a London Bid for the 2012 Olympic Games in a statement to the House on 15 May 2003. One of the criteria the Government required assessment of before support to a bid could be given was 'affordability'. The consultants Arup originally estimated the costs of a London Olympics at £3.6 billion with expected revenues of £2.5 billion. This implied a net public subsidy of £1.1 billion³². In putting together a funding package for the Olympics we have allowed a further £1.275 billion in contingency. This was a cautious response to Arup's estimates of the costs and revenues given that any London Olympics is almost 10 years away and that detailed planning is still to be done. The Government concluded that a public funding package of £2.375 billion was prudent, and details of how that sum could be reached are set out in a Memorandum of Understanding between the Government and the Mayor published on 30 June 2003³³

4. The total public funding package assumes that up to £1.5 billion of Olympic staging costs will be met from the National Lottery. New hypothecated Olympic Lottery games are estimated to be able to generate £750 million for a new Olympic Lottery Distribution Fund between 2005 and 2012. The balance of Lottery funding will be met by:

- £340 million from the established Lottery Sports Distributors
- £0 - 410 million (if required) from changes to existing Good causes' shares between 2009 and 2012 (at the review in 2009)

³² Forecast outturn at 2002 prices

³³ Reproduced at Page 7 of 'Olympics' (Cm5867) the Government's Response to the Culture, Media and Sport Select Committee report 'A London Olympic Bid for 2012' (HC268). Published by the Stationery Office.

5. Once London 2012 Ltd, the bidding organisation, delivers its detailed staging plans to the International Olympic Committee (IOC) in November 2004, budget proposals and required levels of revenue will be clearer. In the event of a successful bid, the expectations set out in the Memorandum of Understanding between the Government and the Mayor will be reviewed (in 2005) taking into account those detailed plans and budget proposals for staging the Games.

6. Bidding for the Olympics is a two-phase process, applicant phase and candidate phase. London 2012 will complete an initial 'applicant questionnaire' by 15 January 2004. The IOC will then determine which cities in the competition should go to the next phase. If London is successful, London 2012 will then submit the UK's full Candidature file by 15 November 2004, then the IOC will visit in the Spring of 2005 to evaluate the proposals and will vote on the selection of a city in July 2005. If the bid is successful a host city contract is entered into with the IOC, and a separate organisation i.e. London Organising Committee (LOCOG) will be established to deliver and manage the staging of the Olympics and Paralympics. The nature of that body, and other associated staging and delivery mechanisms, will be developed as the bid progresses.

(iii) Risk Assessment

7. The measures in this Bill will enable revenues to be generated towards staging the Olympics and Paralympics in London in 2012, and will also enable those revenues to be allocated by a dedicated Olympic Distributor. The public funding package has been constructed to contain headroom for risk and contingency, and has been assessed by Price Waterhouse Coopers for the Government to cover 80% of possible scenarios. Without the measures proposed in this Bill, the funding package would be reduced by £750 million. Without a dedicated Olympic Distributor, there is an increased risk of revenues generated through Olympic Lottery games being ineffectively distributed. The policy which the measures of this Bill propose are therefore designed to address the following risks:

(i) Insufficient funding available for staging the Games in the event of a successful bid. London 2012 will put together detailed estimates of the costs of staging the Olympic Games, which will be approved by Government, the British Olympic Association and the Greater London Authority before being submitted to the IOC in November 2004. If we are successful in our bid, we will need to secure sufficient revenues to meet those proposals and any unforeseen contingencies. Revenues generated through new Olympic Lottery games will form a significant part of the public funding package, and complement revenues from London Council Tax and income from marketing, sponsorship and television rights. In a worst case scenario, failure to meet the costs of staging the Olympics could result in the decision to award the Games being revoked and awarded to another host city. This would mean that any expenditure already committed to Olympic projects could be perceived to have been wasted. The measures in this Bill will enable the generation of an estimated £750 million towards the costs of staging the Games.

(ii) Failure to demonstrate financial capacity to host the Olympics and Paralympics in London in 2012. (or risk to 'winnability' of the bid) The

London bid will be required to provide details of how an Olympic Games budget will be structured and what financial guarantees have been secured from national, regional and local government. The commitment to create new Olympic Lottery games to part-fund staging the Olympics will help to demonstrate to the IOC that the UK has the financial capacity and is willing to legislate in order to host the Games.

(iii) Ineffective distribution of Lottery receipts for Olympic purposes.

In the event of a successful bid, Olympic Lottery revenues will need to be channelled to appropriate recipients to meet the costs of staging the Olympics. Detailed arrangements for staging and delivery mechanisms are not yet known but it is necessary to make arrangements now for how Olympic Lottery revenues will be distributed. It is the intention that creating a lean and focused Olympic Lottery distributor with a small but expert Board will help to ensure that efficient and effective spending decisions are taken in the best interests of staging the Olympics. Consideration was given to whether an existing Distributor might carry out the Olympic Distribution role but was rejected for the following reasons:

- a) Existing distributors have their own objectives and priorities. While it would be possible (in some cases through legislation) to amend a body's Constitution/Charter to include 'Olympic Objects', the Body would still be subject to the control of its main board and influenced by its existing objectives. Any Olympic sub-committee would have to go through the additional layer of bureaucracy of seeking the main Board's agreement on spending decisions, and the Body would inevitably find itself from time to time in a position of conflict of interest over spending decisions. On occasions they would find that their original purpose and priorities were in direct competition with Olympic priorities. This puts the distributor in a difficult position, and has significant potential to delay and complicate Olympic spending decisions.
- b) It is the intention that any new Olympic Distributor should be as lean and focused as possible, and free from historical baggage. The measure proposes that an initial Board of five members be appointed with specific or relevant expertise. This Board would be able to take decisions more effectively than a Board of an existing body or even a specially created sub-committee of an existing Distributor, which would still be answerable to a main Board. Existing Distributors have larger boards than is proposed for the Olympic Distributor and their membership would not necessarily qualify them to make Olympic spending decisions.
- c) Whether an existing Distributor is used or a new body is established, it is the intention that staff numbers and other overheads are kept to a minimum. The Olympic Lottery Distributor will be charged with ensuring minimal bureaucracy and will not be established until the 2012 Games are awarded to London. It is possible that the Olympic Lottery Distributor could be co-located with an existing body

dependent on availability of space at the time of establishment. Another option is that in its early days the Olympic Lottery Distributor might be little more than the Board and an administrator with expertise, with the flexibility to grow or adapt as required. Because Olympic Lottery revenues will be raised and held separately from other Lottery revenues, they will need to be separately managed and accounted for by a Distributor (whether new or existing). This means expected cost savings that might be made by using an existing body would be reduced. There are probably certain savings which could be made through locating a new distributor within an existing organisation (such as some overheads, shared access to human resources and staff facilities for example) however we believe that any additional cost of a new Body would be recouped through the efficiency savings to be made by having a focused organisation with relevant expertise.

- d) Decisions on spending will need to be taken in consultation with the other key funders of the Olympics, namely the Greater London Authority, and with the British Olympic Association. The distributor of Olympic Lottery revenues may be required to take joint funding decisions with those bodies, and to monitor expenditure in a multi-stakeholder, multi-funding source environment. A dedicated body working in conjunction with other funders would be better placed, and more incentivised, to ensure costs were kept down, and that the Olympics were delivered to budget, or with maximum value for money.
- e) Consideration of the existing Distributors which might take on an Olympic Distribution function also lead to the conclusion that none were ready for such a role. Given those circumstances and the fact that an Olympic Distributor would have such a specific time-limited function it was felt a new body would minimise risk to the existing bodies' own programmes and functions, and also to the effective distribution of Olympic Lottery revenues.

(iv) Exposure of the Exchequer to meeting the staging costs. This would be highest if the measure were not introduced leaving a £750 million shortfall in funding assumptions, a reduction in contingency provision, and a much higher risk of an eventual actual shortfall. If called upon it may fall to the Exchequer, the funder of last resort as outlined in the Memorandum of Understanding, to supply the shortfall. This would curtail programmes central to public service delivery.

Options

8. Three options exist:

Option 1 - Do not bring forward proposals for a hypothecated Olympic Game, and do not seek alternate means to raise £750 million towards the funding package for staging the Olympics.

Option 2 - Change the percentage shares of the existing good causes prior to the 2009 review to meet a £750 million revenue profile between 2005 and 2012. Percentage shares are guaranteed to Arts, Sport, Heritage and Charities good causes for the remainder of the period to 2009, the only good cause percentage which could be reduced would be the health, education and environment one which is distributed by the New Opportunities Fund (NOF). This option would therefore mean that any contribution until the review would fall entirely to the NOF.

Option 3 - Establish hypothecated Olympic Lottery games in the event of a successful bid, whose revenues would accrue to a new Olympic Lottery Distribution Fund for subsequent distribution by either: a) the Secretary of State; b) an existing distributor; or c) a new Olympic Lottery distributor. The measure is estimated to operate for approximately seven years from a point beyond a decision by the IOC to award the Games to London and the UK and will be subject to sunset provision in 2014.

Benefits

9. This RIA does not consider the overall benefits of staging the Olympics although a full cost benefit analysis³⁴ was undertaken prior to the Government decision to back the bid.

10. **Option 1** - There would be no reduction to the shares of income to the existing good causes whose revenue assumptions would continue at forecast levels, until the review in 2009.

11. **Option 2** - The income profile would offer more certainty than the introduction of hypothecated Olympic Games (Option 3). Legislation would not be required.

12. **Option 3** - The operator's most recent assessment, as reviewed by the National Lottery Commission, confirms that this option would generate a little over £750 million in revenues between 2005 and 2012³⁵. It is envisaged that new Olympic Lottery games would be part of a wider strategy for growth, which could have the effect of revitalising the Lottery as a whole. The operator will need to undertake further research against their plans, which are being developed to realise a revenue stream for the Olympic Lottery Distribution Fund to underpin these assumptions. The operator's most recent assessment suggests that 41% of the revenue or £308 million will be realised through new sales over the period 2005 - 2012. Annex 1 presents an outline of the assessment including annual revenue profiling. To counter the risk of the under or over-performance of the Olympic Lottery games the operator is also developing contingency plans. These are discussed further at paragraph 26 below. The benefits associated with various distribution options are as follows: a) The

³⁴ London Olympics 2012 Costs and Benefits, 21 May 2002 - ARUP in association with Insignia Richard Ellis. A summary version of the full report is published on the British Olympic Association Website www.olympics.org.uk

³⁵ The operator's financial year runs from January to December. Revenue projections are in nominal terms. Receipt profiles are notional thus not making precise conversion to 2002 prices possible.

Secretary of State acting as distributor would ensure that control of the funding is retained by the Government and bureaucracy is minimised; b) *use of an existing distributor*: would enable decisions to be taken at arm's length from Government, and could present some cost savings on the creation of a new Olympic Lottery Distributor. Based on early estimates and in advance of any detailed decision about how the Olympic Lottery Distributor would operate, indicative savings may be in the range of £0 – £0.2 million one-off and £0.1 – £0.3 million annual recurring; and c) *a new Olympic Lottery Distributor*: would enable decisions to be taken at arm's length from Government by a specially appointed, lean and effective Board with relevant expertise. This would help to ensure that decisions are taken in the best interest of the Olympics and with reduced risk of conflicting priorities. Such a body is more likely to meet the preferences of other Olympic stakeholders the British Olympic Association and the Greater London Authority.

Issues of Equity and Fairness

13. The Government has considered the most appropriate way to fund the 2012 Olympic and Paralympic Games in the event of London's bid being successful and has concluded that the games should be funded by those that will benefit most, or who may wish to contribute. The Memorandum of Understanding was the outcome of this detailed consideration. Against that background Government considered that if exchequer funds were used programmes central to the delivery of the public services would need to be curtailed. Therefore it concluded with the Mayor that London Council Taxes in conjunction with the National Lottery would offer the fairest balance for public funds. Introducing hypothecated Olympic Lottery games rather than simply diverting funds directly from other Good Causes would enable the public/consumer to make a choice to support the Olympics, but would also spread any diversionary impact on the existing Good Causes evenly and across the board, not at the expense of one Good Cause.

Costs

(i) Compliance costs

14. **Option 3** - The operator's development cost of the Olympic Lottery games would be recovered in the normal way in accordance with existing arrangements. Additional costs may arise in using the Olympic symbols, which are protected by Olympic Symbols Protection Act of 1995. Their use would need to be negotiated between the operator and the British Olympic Association, as part of a commercial/marketing arrangement.

(ii) Other costs

15. All the options would have the same impact overall in terms of costs to the UK of approximately £750 million, although who meets those costs will vary depending on the option. Details of how costs would be met according to each option are below:

16. **Option 1** - In the event that no action is taken to raise the £750 million the risk of a funding shortfall for staging the Olympic Games would increase. This option

would have increased the burden on alternative funding sources such as the London Council tax, which might have prevented the Memorandum of Understanding between the Government and Mayor from being agreed. In the event of a shortfall to the funding package, funds would be required from the Exchequer, as the funder of last resort, to the level the measure would have provided. This could therefore equate to £750 million over the period 2005 - 12, or as a straight extrapolation approximately £107 million a year for seven years³⁶. If that sum of money were to be borrowed there would be an additional interest cost, plus a possible slight effect on the costs of all government borrowing due to reduced investor confidence. If it comes from the curtailment of programmes central to public service delivery the further cost is the loss of the welfare that would have been generated by those programmes.

17. **Option 2** - Changes to the existing percentage shares prior to the 2009 review would need to realise an annual transfer that would achieve a £750 million profile over the period 2005 - 2012. As a straight extrapolation - to meet the target revenue assumptions this would represent approximately £107 million per annum over 7 years³⁶. This would have an impact of reducing money available for existing good cause programmes by £750 million. Because of the shares percentage commitment up until 2009 the only source for the £107 million until that time is one good cause (because the percentage share commitment does not extend to the health, education and environment good cause, distributed by the New Opportunities Fund). This would have a disproportionate impact on NOF. Figure 1 below shows National Lottery Distribution Fund income and its distribution across the existing good causes and the impact of the option in 2005/06 based on projected non-investment income at that time.

18. **Option 3** - The operator's most recent assessment, as reviewed by the National Lottery Commission, is that on average 59% of the estimated £750 million income from new Olympic Lottery Games might be diverted from existing good causes. This sales diversion would have a potential impact of reducing income available for existing good causes by around £445 million across the board over the period 2005 - 2012. Based on current forecasts, and a straight extrapolation of the figures across the 7 years this option would lead to an average annual reduction of approximately £64 million to the existing good causes. Annex 1 presents an outline of the operator's most recent assessment including annual revenue profiling. Figure 1 below shows an averaged assessment for 2005/06 based on projected non-investment income at that time, and paragraph 26 sets out the contingency plans that the operator is developing. Other transfers resulting from the £308 million of new sales over the period 2005 - 2012 might include sales diversion from other UK markets.

³⁶ Figure rounded to the nearest million. Assumes financial year April to March.

Figure 1 - Figures shown are rounded to the nearest £m

Good Cause (and percentage of NLDF revenues it receives)	2005-06 ³⁷ NLDF allocation to each Good Cause	Option 2		Option 3	
		Predicted NLDF income to each Good Cause 2005-06 if percentage shares changed prior to the 2009 review	Average Annual Reduction to each Good Cause 2005- 06 if percentage shares changed prior to the 2009 review	Estimated NLDF income to each Good Cause 2005/06 with new Olympic Lottery Games assuming 59% sales diversion	Estimated Average Annual Reduction to each Good Cause 2005-06 with new Olympic Lottery Games assuming 59% sales diversion
Arts (16.66%)	£209	£209	Na	£198	- £11
Sport (16.66%)	£209	£209	Na	£198	- £11
Heritage (16.66%)	£209	£209	Na	£198	-£11
Charities (16.66%)	£209	£209	Na	£198	- £11
Health, Education and Environment (33.33%)	£418	£311	-\$107	£398	- £20
Annual Total:	£1,255	£1,148	- £107	£1,191	- £64³⁸

19. Detailed costings of the distribution mechanism (options 3a, 3b and 3c) will be determined in part by decisions on how to stage and deliver the Olympic Games. For example if the decision is taken for a single LOCOG to be responsible for staging the games, the Olympic Lottery Distributor may in effect be able to delegate considerable decision making on spending to that body. If on the other hand the LOCOG is just one of a number of bodies directly funded by the Olympic Lottery Distributor it may have greater administrative requirements. Decisions on staging and delivery will be taken in the best interests of the Bid and eventual hosting of the Olympics and due regard will be given to ensuring appropriately efficient and cost effective arrangements are made for the Olympic Lottery Distributor.

20. Option 3a for Secretary of State to act as Distributor was ruled out before work was carried out on costing but of the other two options costs will vary depending on LOCOG structures as outlined above. For an existing Distributor (3b) indicative estimates of one off and annual recurring costs are £0.6 - £0.7 million and £0.6 - £1.3 million respectively. For a new Distributor indicative estimates are £0.6 - £0.9 million and £0.75 - £1.6 million respectively. The figures for each option are similar because even if Olympic Lottery Distributor functions were carried out by an existing distributor the majority of the costs would need to be added to their existing running costs. It is currently the expectation that administrative arrangement will be lean, that the Board will be small, and that costs will be kept to a minimum. An illustration of the resources and cost of existing UK wide Lottery Distributors is shown at Annex 2.

³⁷Department for Culture, Media and Sport non-investment income projections (October 2003). It is produced on a level sales assumption i.e. it does not allow for new games delivering sales growth.

³⁸Income profile for a particular year from the Olympic Lottery Games will vary in the achievement of the £750 million revenue target. Further research is required and planned. The operator's most recent assessment of revenue profiling as reviewed by the National Lottery Commission is shown at Annex 1. Using the assessment and a sales diversion level of 59% for option 3 would result in annual reductions of income across all existing good causes until January 2009 when the current guarantee of percentage shares to existing good causes, except NOF, ends is as follows; 2005 - £21 million; 2006 - £29 million; 2007 - £31 million; 2008 - £48 million.

Consultation with small business: The Small Firms' Impact Test

21. The measure does not directly affect small firms. Small firms are currently involved in the Lottery, mainly as ticket retailers.

Competition Assessment

22. The majority of filter test questions would not apply to the measure. The test demonstrates that the only firm affected would be the current or future operator(s) of the National Lottery. The measure will impact on a regulated monopoly provider whose income is derived solely from Lottery-related activity, a proportion of which is passed to Good Causes defined in the Lottery Acts. The current attribution of the returns to Good Causes is shown in Figure 1 above. The filter test indicates that the operator, given the nature of its business, is characterized by technological change.

Enforcement and Sanctions

23. Olympic Lottery games will be licensed by the National Lottery Commission in the normal way. Camelot the existing operator is licensed to operate the National Lottery until January 2009.

24. Distribution of revenue generated by the games would have to comply with the policy and financial directions issued to the distributor, whether a new body or an existing one, by the Secretary of State. Option 3(a) was ruled out as it would lead to a conflict of interest on the part of the Secretary of State being responsible, in this case, both for policy and distribution, but also as the Cabinet Minister currently responsible for strategic oversight of the Olympics.

Monitoring and review

25. The funding assumptions in the Memorandum of Understanding between the Government and the Mayor of London will be reviewed in 2005 in the light of more detailed budget proposals for staging the Games existing. In the event that the bid is successful these plans will form part of the Host City Contract.

26. The operator has also considered potential contingency plans in the event that the new Olympic Lottery Games do not produce the expected returns, or realise sales in excess of those required to deliver £750 million. For the former this would include further games communications, retailer awareness training, and reviewing prize structure and odds. In the case of the latter, in the event that the level of sales diversion from existing lottery games is considered an issue, the reverse could be applied. Annex 1 sets out further detail.

27. The National Lottery Commission will consider the arrangements for licensing a new operator(s) ahead of the January 2009 expiry of Camelot's license. The Government has announced proposals to introduce greater competition into the operation of the National Lottery in its "Lottery licensing and regulation" decision

document published in July 2003, on which the Government plans to bring forward legislation as soon as Parliamentary time allows. The National Lottery Commission will review proposals for games and the performance of the operator in the usual way. It will look to the operator to minimise the impact on core Lottery games and to address any issues of over or under performance.

28. The Government intends for the measures to come into force after, and only if, a decision is made to award the Olympic Games to London in 2012. The measures will also be subject to a sunset provision in 2014 after the hosting of the Games and with sufficient time for appropriate wind-up arrangements to be enacted.

Consultation

(i) Within government

Greater London Authority
London Development Agency
Cabinet Office
HM Treasury
Home Office
National Lottery Commission

(ii) Public consultation

British Olympic Association
Camelot (the operator of the National Lottery)

Summary and Recommendation

Sources of £750m Revenue target and costs 2005 - 2012	<u>Option 1</u> Do nothing. Do not seek £750m	<u>Option 2</u> Change percentage shares prior too the 2009 review to secure £750m	<u>Option 3(b)</u> New Olympic Lottery Games to secure £750m distributed by an existing distributor	<u>Option 3(c)</u> New Olympic Lottery Games to secure £750m distributed by a new distributor
<u>Transfers 2005 – 2012</u>				
Existing Good Causes	na	£750 ³⁹	£445 ⁴⁰	£445 ⁴⁰
Increased ticket sales	na	na	} £308	£308
Other UK Markets	na	na		
Exchequer Underwriting	£750	na	na	na
Total 2005 - 2012:	£750	£750	£753	£753
<u>One off Costs</u>				
Public Sector Legislation cost	na	na	-	-
Use of Olympic Symbols	na	na	-	-
Distributor set up	na	Depends on whether option 3b or 3c taken	£0.6 - 0.7	£0.6 - 0.9
Total:			£0.6 - 0.7	£0.6 - 0.9
<u>Recurring costs 2005 - 2012</u>				
Interest on Government Borrowing	-	na	na	na
Distributor Running costs	na	Depends on whether option 3b or 3c taken	£4.2 - 9.1	£5.25 - 11.2
Total 2005 - 2012:			£4.2 - 9.1	£5.25 - 11.2

29. Option 3(c) is recommended as the option most likely to ensure a robust funding package is in place for staging the Olympics in the event of a successful bid, and most likely to ensure that the impact on the other good causes is equitable across existing distributors. The establishment of a dedicated Olympic Lottery Distributor will help ensure effective and informed decisions on Olympic expenditure are taken without conflict of interest for existing Distributors. While this may result in small additional overheads when compared with the option of using an existing distributor, it is anticipated that these will be recouped in the form of more efficient (leaner and more specialised) decision-making in relation to Olympic expenditure.

³⁹ From one existing Good Cause. No assumption is made as to the source(s) beyond the 2009 review.

⁴⁰ Due to sales diversion across all Good Causes.

Olympic Lottery Games

Introduction

1. This annex draws on Camelot's assessment, as reviewed by the National Lottery Commission (NLC), of the potential hypothecated funding that could be generated by the National Lottery to meet a proportion of the costs of staging the 2012 Olympics and Paralympics.
2. Camelot has been developing a plan for Olympic Lottery games that could produce a revenue stream and some refreshment and innovation of games. It also includes a degree of flexibility dependent on sales performance. Some aspects of the plan will require further development, which will not take place until nearer the time that the games are to be launched.

Research

3. Notwithstanding the further research that will be required, the initial qualitative research undertaken by Camelot between June and October 2003 produced a positive response to the National Lottery supporting the Olympics.

Type of games

4. The precise mix of games and the timings of each Olympic Lottery game will be subject to further careful consideration by Camelot and discussion with the NLC as regulator of the National Lottery. It is in line with normal practice for Camelot to undertake such research as close as possible to the launch of the games to improve the effectiveness of the research. However, at this stage, Camelot considers that the following games merit further consideration:
 - **Pocket change:** This involves a daily game which offers players two chances to win for 1p through a daily raffle game and an instant win game. Camelot considers this to be the most strongly differentiated from existing games in the National Lottery portfolio. It will allow players to reinvest their loose change for a chance to win attractive prizes on a daily basis.
 - **Olympic scratchcards:** initial research has identified that players feel that scratchcards are suitable for generating funds for the Olympics. Olympics-branded scratchcards could therefore be introduced at key times in the run-up to 2012. Other scratchcards would also be launched in the period and would generate returns for existing good causes in the normal way.
 - **Monday game:** Extending the availability of existing game draws is considered a proven way of increasing game play and sales revenue. Internationally, other lottery jurisdictions have also shown that main draws on different nights have a place in the draw based portfolio. There are a number of options for such a game including extending the existing Wednesday and Saturday Lotto games to another night, using the same numbers. An alternative would be for this game to be run in isolation to the existing Lotto draws and to use different numbers. Camelot will undertake further research on the options before launching such a game.

- Olympic event: This game could be based on a 4 games in 1 play style, possibly for a premium price. It is also considered differentiated from existing National Lottery games.
- TV game show: This is considered a key opportunity to generate incremental Lottery game play. Camelot will undertake research on a number of different formats. The game would be run at a different time to the Olympic event game and would offer an entertainment value that would make it a sufficiently different proposition from the event game.

Effect on existing good causes

5. Camelot will conduct further research during the development of Olympic Lottery games to obtain a more detailed view of likely sales and the extent to which these would divert sales from existing games. Camelot will seek to differentiate Olympic Lottery games from existing games in order to minimize this effect. However, drawing on past experience of the introduction of games Camelot's proposals, as reviewed by the NLC, indicates that Olympic Lottery games might derive up to 59% of their sales from existing Lottery games (and therefore from existing good causes).

Licensing

6. Olympic Lottery games will be licensed by the NLC in the usual way. Camelot's existing licence to operate the National Lottery runs until January 2009. Ahead of January 2009, the NLC will consider the arrangements for licensing a new operator(s). The Government has announced proposals to introduce greater competition into the operation of the Lottery in its "Lottery licensing and regulation" decision document published in July 2003, on which the Government plans to bring forward legislation as soon as Parliamentary time allows.

Contingency planning

7. Camelot has also considered potential contingencies should Olympic Lottery games not produce the expected returns or where sales are considered to be in excess of that required to deliver £750m. The former includes further game communications to boost player awareness, further retailer awareness training, reviewing prize structures or the odds of winning. Furthermore, Camelot could also develop additional games. The latter includes, in the event that diversion of sales from of existing games is considered an issue, a number of options could be considered including reducing communication messages, reducing total advertising, adjusting prize payouts and even converting particular games from an Olympic Lottery game to a normal good causes game.

Returns from Olympic Lottery games

8. The precise timing of returns to the Olympic good causes will depend on the introduction of games. Although further research will need to be undertaken, Camelot considers that the range of games proposed could be expected to generate the following returns to the Olympic Lottery Distribution Fund:

	2005	2006	2007	2008	2009	2010	2011	2012	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Total OLDF return	35	50	53	81	126	156	155	97	753

National Lottery Distributors with a UK remit

Distributor⁴¹	Community Fund	Heritage Lottery Fund	New Opportunities Fund	UK Sport⁴²
Annual Operating Costs (£m)	£27	£23	£26	£1.4
Office Locations	Multi (13)	Multi (12)	Multi	One
Board size	17	16	13	11
Appointment period (years)	3	3	3	3
Number of Board Sub Committees	12	16	-	6
Staff	448	209	215	Circa 15
Total 2001/02 Lottery Income (£m)⁴³	£301	£291	£484	£31
Grant Applications Received	14,176	1,424	-	-
Grant Application Value (£m)	£1,168	£681	-	-
Grants Awarded	7,557	2,600	2,897	1,540
Total Award Value (£m)	£351	£366	£642	£57
Notes	Being merged with the New Opportunities Fund		Being merged with the Communities Fund	Review of UK Sport currently being conducted

⁴¹ Source data 2001/02 Annual Reports (except Heritage Lottery Fund 2002/03).

⁴² Annual running costs and staff relate to distribution of lottery receipts. UK Sport has other responsibilities under its Charter for which it received £16m grant in aid. UK Sport employed approximately 80 staff. Non-lottery operating costs were approximately £10m.

⁴³ Heritage Lottery Fund Total Lottery Income 2002/03.