

At Odds With Taxpayers

**Why a cosy deal on the Tote is bad
for punters and the public**

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1. The state's betting monopoly

The Horserace Totaliser Board – or Tote for short – is a state-run bookmaker that has been given many monopoly advantages over its rivals, the on-course bookmakers and the licensed betting trade.

Now, the UK Government plans to privatize the Tote. But rather than sell it on the open market, the Government aims that there should be only one bidder – a new 'Racing Trust' designed for the purpose. The argument is that this new Trust will then be able to put the money it makes 'back into Racing'. But for taxpayers, this cosy deal implies a huge financial loss. Under the plan, the Trust will acquire the Tote's various businesses – including a seven-year monopoly of pool-betting and an extensive network of betting shops – at a discount of roughly 50% of the Tote's value as assessed by an independent valuer. This means a huge benefit to the Racing Trust at the expense of the British taxpayer, and is a setback for competition in the betting industry.

Origins of the Tote

In 1928, Parliament passed the Racecourse Betting Act. This created the Racecourse Betting Control Board, the forerunner of the body now known as the Horserace Totaliser Board, or Tote. The 1928 Act introduced totalisers, a concept that was familiar on French racecourses, to the UK betting market. Since its inception, the Tote has enjoyed a statutory monopoly of pooled betting at all British horse racecourses.

In 1961, betting away from racecourses became legalised. Accordingly, betting shops opened up throughout the UK, but these shops must be licensed. Thus, the term Licensed Betting Offices (LBOs) came into use.

In the early 1970s, the Tote was allowed to open its own network of LBOs. These betting shops only took bets at 'Tote odds', i.e. linked to the betting pool. However, it subsequently became clear that this was not a viable business because the pay out to punters was far too low. Consequently, the Government agreed to allow the Tote to become a fixed-odds bookmaker as well. This placed it in direct competition with a raft of privately owned and publicly quoted bookmaking companies. As a result, competition within the market has been distorted since the Tote was able to rely on Government financial support when it has taken ill-judged commercial decisions.

The Tote's business today

The Tote has greatly expanded the scope of its activities in recent years. In the latest financial year it recorded a 61 per cent increase in annual turnover (£1,471m in 2003/4 compared with £916m in 2002/3). Operating profits prior to exceptional items grew by 53 per cent to £28.7m. However, the Tote

contribution to racing edged up by only 8.4 per cent to £11.6 m (compared with £10.7m in the previous year, 2002/3).

It is often argued that the Tote's contribution to Racing is the main reason why the Government allows it to continue its monopoly of pooled betting for the time being (see, for example, the parliamentary debates on the Horserace Betting and Olympic Lottery Bill and Rt Hon Robin Cook's monthly view article in the *Racing Post*, 21 July 2004).

Yet it is significant to note that, in recent years, the Tote's additional voluntary contribution to Racing has declined as a proportion of its profits (the Tote states this is due to a fall in horseracing margins).¹ Indeed, in previous years it has, on occasions, been withheld in its entirety. Until 1995, the Tote contributed less than £2 million a year, whereas the rest of the bookmaking industry was paying in excess of £50 million. Private sector bookmakers continue to sponsor horse racing in Britain on a significant scale.

Although the Tote made a considerably higher operating profit in the financial year to 31 March 2003, its contribution to Racing fell as a proportion of its profits. Consequently, retained profits transferred to reserves increased.²

Looking at the figures for the year ending 31 March 2004, one discovers that the Tote recorded a gross profit after exceptional items of £23.2 m. But despite this surge in profitability (an increase of £5m on the previous year), the Tote's contribution to racing rose by only £1m. The Tote donated £11.7m to Racing leaving it with a net profit of £11.7m. After paying a tax bill of £4.6m, the Tote channelled £7m into its reserves.

As Peter Jones, the Chairman of the Tote, highlighted in his comments on the annual results for the year ending 31 March 2004, the "key driver in the Tote's 2003/4 performance was its betting shop division of 457 shops, where gross win increased by 40 per cent primarily due to the roll out of Fixed Odds Betting Terminals (FOBTs) which accounted for over half the growth."

The Tote's monopoly benefits

The Tote enjoys certain advantages over its private sector rivals when it comes to accepting bets from punters. Currently, punters can choose between three options when it comes to placing a bet on a race at a UK racecourse. They can:

- (i) Place a bet with a traditional boards bookmaker offering fixed odds. However, these bookmakers are only allowed to operate from the Tattersalls Stand of the racecourse.
- (ii) Participate in the Tote pool, which is a Pari Mutual system of pool betting.³ In contrast to other bookmakers, the Tote has kiosks

¹ Horserace Totalisator Board, Annual Report and Accounts 2003, p17.

² Horserace Totalisator Board, Annual Report and Accounts 2003, p20.

³ The Tote recently negotiated a new levy rate of less than ten per cent with the Horse Race Betting Levy Board, which is lower than the ten per cent paid by off course bookmakers for their Tote Pari Mutual

strategically placed all over the racecourse, including the licensed bars where bookmakers are forbidden. The Tote is uniquely favoured in so far as it is permitted to employ representatives to approach and accept bets from punters anywhere on the course.

- (iii) Place a bet with a fixed odds betting shop located on a racecourse and run by an off course bookmakers, such as Ladbrokes, Coral, William Hill & Stanleybet. The Tote also offers this service in competition with private sector bookmakers.

Given the Tote's existing advantages, its proposed sale to a Racing Trust leaves many in the betting industry alarmed about the potential for abuse. For example, once the new Gambling Bill gains parliamentary approval racecourses will be allowed to open casinos as well as racinos on their premises. Racinos, essentially rooms brim full with numerous slot machines, are likely to prove a highly profitable business. Bookmakers are concerned that the Tote, given its future ownership and with its close ties to racecourse owners, will enjoy an unfair advantage when it comes to applying for licences to operate casinos and racinos. What is more, the profits generated from these businesses could be used to subsidise the Tote's off-course operations.

business on racecourses. The new levy rate is equivalent to six per cent of gross profits, a rate that enables them to be highly competitive in the marketplace. Furthermore, the Tote also reduced its deductions rate from 16% to 13.5% on the win pool, and 24% to 18% on the placepool.

2. The legality of the sale in EU law

The EU Treaty specifically outlaws state aid where this is likely to lead to a significant distortion in competition. The proposed sale of the Tote to a private sector body, the Racing Trust, may well be an illegal use of state aid that is bound to have a seriously distorting impact on the UK betting market.

EU law on illegal state aid

Article 87 (1) of the EU Treaty stipulates:

“Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market”.

The European Court of Justice has ruled that a measure must be regarded as state aid if it confers on the enterprise in question an economic or financial advantage that it would not otherwise enjoy.

In privatization cases, the Commission has consistently argued that, in the absence of an open and unconditional tendering procedure aimed at selling the assets to the highest bidder, the sale must be notified to the Commission for a decision as to whether state aid is involved, and, if it is, whether this is illegal under Article 87. It would seem that the Tote sale should also be notified in this manner.

In the past, when EU Member States have declined to hold an open and unconditional bidding procedure (as would occur if the business was auctioned), and instead sought to sell state owned assets for less than their market value, the Commission has ruled there is a *prima facie* case that an illegal advantage has been awarded.

The proposed sale

Despite some initial controversy over who precisely owns the Tote⁴ the Horserace Betting and Olympic Lottery Bill, due to receive Royal Assent, provides the legal authority, conferred by Parliament, for the Government to sell the business to the private sector. Though the market value of the business is generally agreed to be at least £500m, the plan is for the buyer, the Racing Trust, to pay only a fraction of this, leaving taxpayers disadvantaged.

⁴ This issue was extensively debated, for example, in the House of Lords Second Reading of the Bill.

Because the Racing Trust will not be paying a fair market price for the Tote, the Trust will effectively be receiving a covert state aid, unavailable to rival firms of bookmakers. This is clearly inequitable and against the provisions of the EU Treaty.

Furthermore, the proposed new owner of the Tote, the Racing Trust, will enjoy an unfair advantage over its rivals in the UK betting market, notably through the retention of a statutory monopoly of pool betting on race horses for a period of seven years. The proposed sale will confer a financial and economic advantage on the Trust – and its beneficiary, the racing industry – which it would not otherwise enjoy. This would appear to contravene Article 86 of the EU Treaty, which stipulates that Member State Governments are not allowed to grant special and exclusive rights without a reasonable justification.

The Tote's anti-competitive advantages

The Tote, through its monopoly right of pool betting on horseracing, it is placed at an unfair advantage *vis a vis* rival bookmakers. This monopoly generated a turnover of £269m in the year to 31 March 2004 – a 22 per cent increase on the previous twelve months. Since it can count on a guaranteed income stream from its core monopoly business, this means that the Racing Trust will be tempted to cross subsidise a range of other product offerings to customers. For instance, the Racing Trust will be in a position to cross-subsidise from its pool betting revenues the operational costs, future acquisitions and technological investments of its fixed odds business.

The Tote's protected commercial position has assisted it in outbidding rival bookmakers for licensed bookmakers' retail premises across Britain. If the Tote is sold to a Racing Trust, the new owner will acquire an extensive national network of Licensed Betting Offices (LBOs) at a fraction of the price paid by the Tote. This places the new owners at a significant competitive advantage to their rivals who have had to outlay substantial capital sums to build up their own national networks of LBOs. Also, by transferring the Tote to a Racing Trust at a substantially discounted price, the new owners will be in an unfair position to outbid competitors when further licensed bookmaking premises come up for sale.

As a result of its protected status, the Tote has developed a powerful brand over its 70 year history. In recent years it has allocated significant sums to developing two sub-brands, TOTEPOOL and TOTESPORT. These brands represent an attractive and valuable asset that other potential purchasers may be prepared to acquire at a substantial premium.

In addition, the Tote has spent considerable sums launching its own internet betting website and electronic point of sale systems in its network of 457 betting shops. The Racing Trust will enjoy the benefits of these investments without paying a fair price to acquire them.

Conflicts of interest in licensing

The proposed Racing Trust may derive an unfair competitive advantage through its role as licensor of pool betting products. (In this context, it effectively regulates horserace pool-betting).

In order to operate their business, all bookmakers must apply to the British Horseracing Board (BHB) to obtain a licence. This enables them to receive the data that lists the runners, jockeys, race times, etc. for their betting customers. In return for this licence, bookmakers must pay a fee that is negotiated with the BHB. The current fee is based on 10 per cent of a bookmaker's gross profits.

However, this arrangement is due to expire in 2007. A new arrangement will then have to be negotiated, which could trigger serious distortion in the betting market for horseracing. On renewal, if the Racing Trust is then the owner of the Tote, and the Tote continues to expand its betting shop estate, an agreement between the BHB and the Tote over data would place the bookmakers in a difficult position. By 2007, the Tote is likely to have consolidated its nationwide presence across Britain, with LBOs in all major population areas.⁵ Consequently, if the Tote agrees to a higher data charge, a domino effect may well take place, causing the bookmakers to surrender to the proposed new charging schedule. If the Tote readily agrees to the BHB's revised fee for supplying data, other bookmakers will be unable to resort to the negotiating tactic of holding out, since a major nationwide chain of LBOs will have already agreed to the revised tariff scale.

The Office of Fair Trading (OFT) is particularly concerned about the BHB's proposals for arbitration in the event that agreement cannot be reached between the two parties to this negotiation, i.e. the BHB and bookmaking community.

In applying to the BHB for a licence, bookmakers must submit audited certificates revealing the payments they receive from punters, based on gross profits. It needs to be emphasised that this is highly sensitive commercial information because the BHB will be able to form an accurate view of the amount of business going through individual LBOs. What is of particular concern is that the Racing Trust's board is likely to include members who represent the BHB.

A Shadow Racing Trust has already been formed. The board is made up of a consortium of horseracing interests with an independent chairman, who we understand will be Lord Lipsey. According to the Department of Culture, Media & Sport's (DCMS's) website, the rest of the board will comprise of representatives from the Racecourse Association, the Racehorse Owners association, the British Horse Racing Board (BHB) and the Industry Committee of the BHB. However, this raises a potential conflict of interest.

⁵ The Tote's report and accounts for the year ended 31 March 2004 notes on page 12 that "the successful growth of our retail estate (is) consistent with our aims to reinforce the totesport brand in high street locations up and down the country and cement our position as a national presence in the off-course betting market". The Tote's retail presence is likely to expand even further by 2007.

Commercially sensitive information could be communicated to the Tote by some of these representatives, albeit unintentionally. Accordingly, from a corporate governance standpoint, sufficient and reasonable safeguards will need to be taken to ensure the Tote is not given an unfair advantage.

As currently constituted, it should be noted that several members of the Tote's board are members of either the BHB, the Jockey Club or the Racehorse Owners Association (details can be found on pages 18–19 of the Tote's report & accounts for the year ended 31 March 2004).

What benefit for Racing?

Despite the often repeated claim that the proposed Racing Trust's intention is to operate for the wider benefit of racing, it does not appear that it will be under any obligation to maximise its profits. We understand that rival firms of bookmakers are concerned that the Trust's apparent lack of incentive to obtain the best commercial deal with its suppliers could lead indirectly to a significant increase in its competitors' overheads. What is more, since the Racing Trust is likely to acquire its network of retail betting shops at a considerable discount, it will be in a far better position to absorb higher overhead costs levied by the BHB.

To be more specific, it might, for instance, be in the Racing Trust's interests to raise additional revenues for the horse racing industry as a whole, by using the Tote's traditional bookmaking operation as a means for increasing the effective price paid by bookmakers for a Tote licence. They require such a licence to accept bets that then go into the Tote's pools.

If the past is an accurate guide to future intentions, this is a clear probability. In March 1995, for example, the Tote trebled the charges it levied on bookmakers who applied for a licence to take bets on Tote odds.

By way of illustration, it is conceivable that the BHB might well wish to introduce a substantially higher charge for information linked to its own database. As noted above, bookmakers need this specific information to take bets on horseracing. If such an inflationary charge was to occur, then the Racing Trust, in respect of the network of Tote owned LBOs, would be much better placed to absorb these increased tariffs.

This stance, in turn, would increase the pressure on other bookmakers to accept the inflated charges. Yet from the Tote's (and the Trust's) perspective, any move by the BHB to increase its level of charges to bookmakers would be cost neutral. Why is this so? If one analyses the Government's proposed plans to transfer ownership of the Tote to a Racing Trust, then it becomes clear that, although a higher level of charges levied by the BHB would increase the Tote's own overheads, the financial benefit would still be passed through to Racing. The point being that the income would flow from the BHB – because it will be generating higher fees from licence payments for its data – rather than the Tote.

Consequently, there would be no incentive for the Tote to refuse the initial terms proposed by the BHB. This is a distortion of competition. Like its rivals in the bookmaking sector, the future owner of the Tote should seek to negotiate the best commercially acceptable deal, reflecting what is generally perceived as the fair market value for the data supplied by the BHB.

In addition, under the UK Government's proposed plans, the Racing Trust is likely to enjoy the ability to restrict the commercial freedom of its pool betting licensees by ratcheting up the licence fee they are obliged to pay to take bets at the odds quoted by the Tote. Consequently, bookmakers who refuse to pay inflationary licence fees will be effectively prevented from competing on a variety of Tote products.

On- course advantages

In the past, the Tote has enjoyed an unfair advantage over its commercial competitors in so far as racecourses allow it to site its own booths throughout the course, whereas rival bookmakers are only able to operate from the betting ring.

What is more, bookmakers have to pay for their pitches,⁶ whereas the Tote does not (on the grounds that a percentage of its profits flow back to Racing). The Tote is also able to offer betting services in the owners' and members' enclosure, where high stakes are often placed. This is a clear distortion of competition.

Also, racecourses favour the Tote by permitting its sales representatives to approach punters with hand held terminals in racecourse bars, restaurants and hospitality boxes. Rival bookmakers enjoy no such privilege. If these practices were to continue, they would constitute a clear distortion of fair competition.

⁶ Racecourse bookmakers have to bid for pitches through the National Joint Pitch Council (NJPC), which is a part of the Horse Race Betting Levy Board. They are assigned a fixed pitch from where they must trade; they are not allowed to stray outside this fixed position.

3. The booming world of Racing

Does Racing actually need a few hundred million pounds' worth of subsidy from the UK taxpayer? In fact, horse racing is enjoying a boom. There are now more fixtures than ever and the size of the betting market continues to grow. As Andrew Lee points out in a recent report on William Hill, the publicly listed bookmaker: "The horse racing fixture list has increasingly opened in recent years with more fixtures at more times during the week to satisfy consumer demand and spare racecourse capacity. 2004 fixtures have received a huge boost with Sunday and evening racing growing dramatically."⁷

Table 1 shows that this year the number of fixtures is scheduled to be 5.5 per cent higher than last year. The number of evening events has risen by over a third and the number of Sunday fixtures has almost doubled (88.6 per cent). The number of fixtures is due to increase to 1,500 in 2005⁸ and, as prize money has increased, owners have a greater incentive to race their horses in Britain rather than overseas. All these trends point to the sport's willingness to adapt to changing leisure patterns.

According to evidence from William Hill, quoted in a recent OFT report,⁹ the total amount of bets placed on horseraces, both UK and foreign, totalled £5,975m in 2000, of which £5,543 m was staked off course. William Hill estimate that betting turnover at licensed bookmaking offices (LBOs) came to £4,623 m or 77 per cent of the total. In addition, UK punters staked £780m via the telephone (13 per cent of the total) and £140m via the internet (equivalent to 2 per cent of the total annual volume).

Table 1: Horserace fixtures held in Britain 2004 compared with 2003

FIXTURES	2003	2004	INCREASE %
Fixtures	1,270	1,340	5.5
Sunday fixtures	70	132	88.6
No of Sundays in year	24	47	95.8
Evening fixtures	167	223	33.5
No of evenings in year	81	117	44.4

Source: *britishhorseracing.com*

Since 2000, the size of the online market has grown significantly. Furthermore, there is now a lively and active market in betting exchanges (for further

⁷ *William Hill: form strong – going good*, by Andrew Lee, a leisure and gaming analyst at Dresdner Kleinwort Wasserstein, UK Equity Research, 10 March 2004.

⁸ 'Owners urged to make tracks pay fair price', *Daily Telegraph*, 12 July 2004.

⁹ UK Betting Services, Annex 3, Office of Fair Trading

details on this fast expanding market, consult *Double or Quits*, the third annual report on the global gambling industry, issued in October 2004 by Global Betting & Gaming Consultants, www.bettingconsultants.com).

As *The Economist* has pointed out, “By abolishing betting tax in October 2001, the Government has brought almost all British owned offshore betting businesses back to this country: turnover has risen from £8 bn to £15 bn, of which a big chunk – up to a third on big events – is already wagered from abroad.”¹⁰ After abolishing betting duty and turnover tax on bookmakers in October 2001, the UK Government introduced a new 15 per cent tax on bookmakers’ gross profits, the level at which bookmakers claimed they could offer tax-free betting. While this led to a temporary shortfall in tax receipts, this decision has acted as a catalyst on the size of the UK gaming industry. As the *Double or Quits* report reveals, over the last three years there has been an impressive fivefold increase in the turnover of LBOs. While the Exchequer suffered a temporary shortfall in tax receipts, tax revenues should soon surpass the levels generated prior to the abolition of betting duty.

The UK is widely seen as having the most professional odds-making skills in Europe and one of the most effective forms of betting regulation in the world.¹¹

Although punters have begun to gamble on other sports, horseracing is still the predominant element in the market. It continues to be the second most widely televised sport in the UK after soccer. What is more, racecourse attendance has become increasingly popular. After a fall in attendance in the 1970s and 1980s, the number of people passing through the turnstiles is now higher than for forty years (In 2002, total attendance came to 5.5 m, the highest figure since 1959).

One can therefore reasonably conclude that horse racing is in better shape than ever. More people are attending fixtures than ever, and the number of ways in which individuals can bet on the outcome of races continues to expand.

¹⁰ ‘Flutter away’, *The Economist*, 8 May 2003.

¹¹ See ‘More punters and deregulation put gaming industry ahead’, *Financial Times*, 6 October 2004.

4. What is the Tote worth?

If Racing is booming, what then is the Tote worth? According to investment banks in London, the Tote is worth at least £500m on the open market. This is also the figure referred to by several contributors in the parliamentary stages of the Horserace Betting and Olympic Lottery Bill¹². The main value in the business is the extensive network of LBOs. Currently, the Tote owns and operates 457 betting shops. In the financial year to 31 March 2004 these retail operations contributed over two thirds of the Tote's aggregated turnover (£991,538,000 out of a total turnover of £1,471,094,000, equivalent to 67.4%).

In the off-course market, the Tote is currently the UK's fifth largest bookmaker, a position it recently consolidated through its acquisition of Seymour & Story's chain of 41 shops, W R Bird's eight shop train in Essex and South London, and William King's 12 LBOs in Greater Glasgow (see Table 2).

The Tote paid an average of £570,000 for the betting shops it acquired from Seymour & Story last year and an average of £625,000 for the eight shops it purchased from W R Bird, again in 2003. Using these as the basis for a current value of the LBO estate, the total value is likely to be worth anything between £261m and £286m. However, the true worth is likely to be far higher.

In this regard, it seems that the Tote has been busy buying shops at inflated prices knowing that they will be able to buy them back at a fraction of their market value as soon as the Racing Trust takes over ownership of the Tote.

Indeed, the Tote has doubled the size of its LBO estate since 1999, often outbidding rival bookmakers in the private sector. For example, we understand that when William King put 12 of its LBOs on the market, the bidding began at around £4m (£400k per betting shop). The price subsequently soared to over £5m. When the price climbed above £5.4m, Corals withdrew from the bidding and the chain of a dozen betting shops was finally sold to the Tote, which paid £5.6m, or £467K per LBO. For a detailed breakdown of the Tote's recent LBO acquisitions, see Table 2.

¹² For example, Lord Donoughue, who previously worked for the stockbroking firm, Kleinwort Grieveson Securities, stated in the House of Lords Report Stage Debate on 14 September, 2004, column 1039, that he had heard City sources floating valuation figures as high as £500 million.

TABLE 2: LBOs acquired by the Tote since May 1999

DATE	BUSINESS ACQUIRED	AMOUNT PAID	AVERAGE PRICE PAID PER LBO
Nov/Dec 2003	W R Bird (8 shops)□	£ 5m	£625k
Dec 2003	William King (12 shops)□	£5.6m	£467K
November 2003	Seymour & Story (41 shops)	£23.4m	£570k
April 2002	Burnstein (30 shops)	£7.1m	£236k
February 2002	Turnbull Racing (? Shops)	£1.217m	?
October 2001	Frank Irish & Laurie Devlin (14 shops)	?	?
November 2000	George Habbershaw (12 shops)	£1.9m	£158k
May 2000	Jim Ramsbottom (13 shops)	£4.2m	£323k
December 1999	Peter Smith (37 shops)	£7.2m	£195k
November 1999	Skyport (8 shops)	£3.8m	£475k
May 1999	Mike Dines (32 shops)	£12m	£375k

Source: The Tote's annual report & accounts.

Fair value, or fixed?

Richard Caborn, the sports minister, restated in Parliament on 20 January 2004 that the Government was committed to arranging an independent valuation of the Tote prior to sale. In this regard, it has appointed PriceWaterhouseCoopers (PWC) to undertake this valuation exercise. Furthermore, he indicated, "that if a sale took place to a Racing Trust, there

would be broadly a 50:50 split of the asset between the taxpayer and the racing industry, because we believe that that is fair.”¹³

On behalf of the Tote, N M Rothschilds, the investment bank, has undertaken a separate valuation exercise. However, the figure calculated by Rothschilds differs from the total estimated by PWC by the sum of £50m.¹⁴

The Shadow Racing Trust will have the opportunity to submit a bid for 50 per cent of the ‘fair value’ of the Tote, yet ‘fair value’ is not the same thing as a market valuation.

Formal negotiations between the Racing Trust and HM Treasury will commence once the Bill has received Royal Assent, expected in late October 2004.¹⁵ Only then will the final hurdle, the question of price, be formally addressed. From everything we have learnt to date, the final figure is likely to be in the order of £150m, at least £350m *less* than the market value of the Tote’s various businesses.

The justification for such a low price is that the Tote would not be able to service the debt interest on a figure much higher than £150m.¹⁶ Indeed, Peter Jones, in his chairman’s statement in the latest report & accounts, warns that the Tote “could still be crippled by debt if the Government asks too high a price for its share of the Tote.”¹⁷

Yet this observation begs a crucial question. The sale of the Tote and its monopoly to a Racing Trust may only be crippling in so far as the Trust has no money of its own. Consequently, it must borrow from the debt markets and then service and repay this debt.

If the Tote was sold by auction on the open market, the widest possible number of buyers would be presented with the opportunity to bid. No doubt, taking into account their keen interest in bookmakers generally, a range of private equity funds might seek to bid for the Tote. The recent record has shown that private equity funds can add significant value to these businesses.

They do so because they have a real incentive to grow the business and make it more efficient. By restructuring the business and making a bookmaker more competitive in its range of product offerings to customers, the private equity house (or houses) can then sell the business on to another buyer once it is beginning to perform well (in the case of private equity funds, this period of time is usually between four to seven years).

This wealth creation process is well illustrated by Charterhouse Capital Partners, which acquired Coral Eurobet Ltd, in September for a total sum,

¹³ source: *Hansard*, column 010, 20 January 2004

¹⁴ see House of Lords Report Stage Debate on the 14 September.

¹⁵ *See Racing Post*, 15 September 2004.

¹⁶ As yet the Racing Trust does not exist. It will need to be formally constituted as a legal entity. Nor does the proposed Racing Trust have any money. All the money it requires to purchase the Tote must be borrowed in the form of debt capital. In order to raise this money the Tote will need to service the debt through the income generated from its monopoly of pooled betting and the funds generated from the rest of the Tote’s business.

¹⁷ Report & Accounts for the year ended 31 March 2004, page 9.

including debt and operating cash, of £860 million. Coral ranks as the UK's third largest and fastest growing off-course bookmaker, with a nationwide network of 870 LBOs.

Many industry observers reckoned that Charterhouse had paid too much for Coral, but two years later the business is now valued at approximately £1.4 bn,¹⁸ an impressive growth performance in just two years.

Why should taxpayers subsidize this business?

It is bad policy, and bad for taxpayers, to sell the Tote, with its strong brand image and its monopoly of pool betting, for 50 per cent of the 'fair' value – a figure which is likely to be considerably less than the true market value.¹⁹ It would appear to us to be even more bizarre to sell the Tote to a non profit making Racing Trust when provision is made in the new Act to sell the Tote on the open market (through an auction process, for example) and then allocate up to 50 per cent of the proceeds to Racing.

If an open market sale was undertaken and the industry²⁰ given up to 50 per cent of the proceeds for a range of good causes, e.g. training, retirement funds, sponsorship, etc., all concerned in horse racing would be much better off than they are currently, having to rely on the relatively meagre sums they receive from the Tote.

As argued by Keith Boyfield in *The Independent* (15 July 2004), it appears – at best – puzzling why the horse racing industry should receive any such largesse, given the fact that it is a commercial sport and that owners of race horses, by definition, tend to be relatively wealthy individuals (many of whom live outside the EU in various tax havens or clustered in the Gulf). Taxpayers will be disadvantaged because they are likely to receive only a fraction of the market value for the Tote's assets. Furthermore, there is likely to be a redistribution of income from UK taxpayers, many of whom are on low incomes, to wealthy race horse owners, many of whom are not domiciled in the UK.

If the Government is allowed to dispose of the Tote for a relatively paltry sum, it will constitute a grossly unfair distortion of competition, since the Tote will enjoy both a monopoly of pooled betting and a network of LBOs, which it will inherit for a fraction of their true market value. Under the ownership of a Racing Trust, the Tote would be able to channel income from its monopoly and extensive network of LBOs into a range of product offerings that directly compete with bookmakers that do not enjoy any form of monopoly. But in doing so, the Tote will be placed at an unfair advantage to its competitors in the private sector, since they have had to build up their respective chain of betting shops through paying the market price for these assets.

¹⁸ Source for estimated value: Global Betting & Gaming Consultants, www.bettingconsultants.com

¹⁹ We understand the arbitrary figure of 50 per cent was plucked out of the air by one of the DCMS civil servants, who turns out to be a fan of equestrian sports.

²⁰ According to the BHB, the industry employs up to 100,000 people in the UK.

Furthermore, the Tote will be able to channel income from its monopoly business and its network of LBOs – acquired at a substantial discount to their true worth – into a marketing programme aimed at winning greater market share. Already, the Tote has spent considerable sums on developing separate brands for its various businesses (see the Tote's Report & Accounts for the year ended 31 March 2004, 'the brand of the future' page 1 and chairman's statement, pages 5–9).

If the UK Government sells the Tote at a heavily discounted price, the new owner will be able to fund future capital expenditure at an enhanced level, thereby disadvantaging its competitors. Since its debt level will be lower than it would otherwise be if the Racing Trust was required to pay the true market value, it will enjoy a greater facility to borrow from the capital markets for upcoming investment programmes.

Implications for cross border trade between EU member states

From a punters' perspective, horse racing is becoming more international. In recent years there has been far greater coverage of horse racing events in other countries, notably Ireland, France, Germany and Italy. These events offer an alternative betting product for UK punters. Likewise, it is now quite common for horses in training in Britain to race in other Member States, including France, Ireland, Italy and Germany, and for horses in training in continental countries to race at British fixtures. One can therefore reasonably say that betting on horseracing is now a pan-EU market.

The Tote's privileged and unjustifiable competitive position will damage competitors based in other EU member states, notably Paddy Power plc, which has businesses in both UK & Ireland; Ladbrokes, which operates in both Belgium and the UK; and Stanley Leisure, which operates in the UK & Ireland. It should be emphasised that the Tote's call centre and Internet service can take bets from customers based in all the other member states of the EU. It is our view that the Tote, under its new owner, the Racing Trust, will be able to offer these services at an unfair competitive advantage.

5. Why the Tote should be auctioned

It is our view that the proposed sale of the Tote to a Racing Trust for a fraction of its true market value constitutes a clear infringement of competition law and EU law against illegal state aid. To summarise, the proposed sale:

- Distorts competition between bookmakers offering betting services to customers, whether UK based or living in other EU Member States, on British horse racing events.
- The UK Government has refused to hold an open and unconditional bidding procedure for the Tote, and instead proposes to sell this valuable state owned asset (conservatively estimated to be worth £500m) to a private sector body, the Racing Trust. This strongly suggests that an illegal advantage has been awarded and constitutes a *prima facie* case for investigation by the Commission.
- The new owner of the Tote, the Racing Trust, will enjoy an unfair advantage over its commercial rivals in so far as it will retain a monopoly of pool betting on racecourses in Britain for seven years. This will confer a financial and economic on the Trust, which this private sector legal entity would not otherwise enjoy. This would appear to contravene Article 86 of the EU Treaty, which stipulates that Member State Governments are not allowed to grant special and exclusive rights without a reasonable justification. To date, in our view, no such justification has been given by the UK Government.
- The income generated from the Tote's core monopoly business is likely to be used to cross subsidise other Tote business ventures, including the purchase of LBOs and (in future) the establishment of racinos on race courses.
- The Racing Trust may also derive an unfair competitive advantage through its role as licensor of pool betting products.
- The proposed membership of the Racing Trust board also gives considerable cause for concern. Several of these board members who represent particular vested interests (the Jockey Club, the Racecourse Owners Association, the BHB) may face a potential conflict of interest.
- The Tote already enjoys advantages over other bookmakers in so far as it is free to site its own booths anywhere on the racecourse, and its sales representatives can also accept bets from punters on at racecourse bars, restaurants and hospitality boxes. Why should these privileges be allowed to continue?