

Edward Wray
Director

15 July 2003

Direct line:
020 8834 8205

Fax:
020 8834 8010

E-mail:
edward.wray
@betfair.com

OPEN LETTER TO AUSTRALIA'S RACING MINISTERS

Response to Betting Exchange Task Force Report

Dear Ministers,

We write to you to express our dismay at the deficient process and prejudicial findings of the recent Betting Exchange Task Force. Betfair believes that Australia's Racing Ministers, the industry and punters all have a right to be disappointed with this result.

For this reason, we have decided to draft this as an 'open' letter in response to the Task Force report. Betfair has always been, and will continue to be, transparent and accountable to all stakeholders in Australian racing.

With much goodwill, and as the world's first regulated and biggest betting exchange, Betfair sought to participate in Task Force deliberations into the merits (or otherwise) of betting exchanges in the Australian context, and into how, if licensed in Australia, this new form of wagering would impact the local market.

We did so in the reasonable expectation that the "independent" report would consider all the features of the betting exchange phenomenon, namely its:

- impact on racing in all forms;
- impact, if any, on state revenues;
- implications for the integrity of the racing industry and funding of races; and
- effect on the industry's stakeholders (owners, trainers, jockeys and punters - without any one of whom racing ceases to exist).

Instead, the report is weighted with contributions from established vested interests. It makes only summary and superficial reference to the positives associated with betting exchanges; the successful regulatory model that operates in the UK; and, importantly, its rapid acceptance by punters.

Betfair's experience was that the Task Force had no real interest in engaging with us constructively as the world's largest betting exchange (despite the fact that Betfair's operation in Australia is centrally at issue). Beyond an initial videoconference presentation (and despite repeated approaches to the Task Force) we were unable to talk to the Task Force (including during a visit to Australia by

me and other senior Betfair staff), let alone engage in a constructive two-way dialogue.

It quickly became apparent to us, early in the process, that the Task Force was conducting its review on the basis of factual inaccuracies and incorrect assumptions, and it was, therefore, particularly disappointing that the Task Force repeatedly refused to meet with us. It would have been easy to correct these misconceptions and prevent the release of a report that clearly contains errors.

Betfair believes that the conclusions of this Task Force report were pre-determined. The fact that NSW regulators, in particular, submitted strong anti-betting exchange views to the Commonwealth's review of the *Interactive Gambling Act* in April 2003 – almost before the Task Force had even commenced its work – supports that contention.

We also believe that the key finding – that betting exchanges allegedly diminish the integrity of Australian racing – is a veneer for the Task Force's underlying concern, namely that betting exchanges offer the potential for real innovation and competition in the provision of betting services. Betting exchanges are indeed disruptive to the complacent business models of monopoly incumbents, and to entrenched relationships, and Betfair does not apologise for this. But as Betfair has repeatedly stated, it is committed to obtaining a licence in Australia; to paying the relevant taxes to Australia governments, and to remitting appropriate product fees. Under Betfair's business model, neither Australian racing nor any state which licences Betfair will suffer any funding shortfall.

It is important that Betfair tables with Racing Ministers at least some of the key concerns that it has with the arguments and findings of the Task Force as published in this report. We would be happy to provide further detail on any of these issues and concerns, which include:

1. Views of the Punter and the Industry

The views of the largest stakeholder affected by the decision - that is, the Australian punter - were not represented at all. Nor were they sought.

The report offers a spectacular assumption about what punters think of betting exchange integrity. It states:-

"..... the mere presence of betting exchange operations on Australian racing events would likely adversely affect punter perceptions regarding racing integrity and consequently undermine punter confidence in wagering on Australian racing."

How does the Task Force know this? Which Australian punters (by definition TAB customers) did it ask? Where is the quantitative research that verifies either this or other presumptions of punter behaviour or attitudes?

Betfair is also bemused at the Task Force's treatment of the industry in the report. It is striking that the Task Force appears to concede only grudgingly that the industry's peak national body, the Australian Racing Board, as well as Racing Victoria Limited, believe that the appropriate regulatory response to betting exchanges is regulation rather than prohibition (an approach strongly supported by Betfair).

Whereas significant industry stakeholders are prepared to retain an open mind to a regulated approach and a cooperative and consultative dialogue on integrity-related issues, such an approach has been summarily rejected by the Task Force. The question has to be asked: what are the real interests which the Task Force is trying to protect in its report?

2. Integrity of Racing

The Task Force's dismissal of the notion that the real and perceived integrity of racing is Betfair's most valuable asset is not simply insulting; it fails completely to understand (or chooses to ignore) the fact that the first principle of Betfair's business methodology is to protect and preserve it. To do otherwise implies that Betfair is trying to destroy the very sport that sustains it and makes it profitable. In short, we have the same vested interest as the industry itself.

If our agenda were short term, why would Betfair approach each Australian State, Territory and racing body and urge a transparent regulatory framework for betting exchanges; involving a formalised audit-trail mechanism to oversee wagering integrity; product licence fees to be paid by Betfair (on a basis comparable to other bookmakers and TABs); and an agreement by which Betfair would pay tax?

None of this has been acknowledged by the Task Force. It ignores that Betfair is so highly regarded by regulators and government in the UK that we have just become the first gambling company to receive the Queen's Award for Enterprise.

Betfair supplied the Task Force details of its probity measures to monitor suspect wagering, laundering, and other anomalous behaviour - including a formal Memorandum of Understanding with the UK Jockey Club - but the Task Force seems to have decided that none of these measures exist.

"..... the Task Force noted the current absence of any cost-effective or proven control mechanisms to deal comprehensively with the racing integrity concerns that have been identified."

Did the Task Force bother to ask anyone whether or not Betfair has agreed (which it has in writing to the Australian Racing Board) to give racing stewards unfettered access to all betting records on Australian racing? It would seem not. Why not?

On any given sporting event we know the identity of the punter, and can often pinpoint problems before a race takes place. We will disclose anomalous betting patterns when the on-course performance of a horse arouses suspicion. Our computerised audit trail - right down to each and every key-stroke by a punter - is stored, can be replayed, and ultimately can be used by regulators as evidence in a courtroom. Honest punters are welcomed, and sign an understanding of this pre-condition before they can bet. Corrupt punters will be caught.

The system has been put in place by Betfair at Betfair's cost. It has cost the British racing industry nothing. It will cost the Australian racing industry nothing. We challenge the incumbents in Australian racing to establish an integrity mechanism that comes anywhere near this standard of surveillance, and then apply it to all bets that are handled by the TABs. For good measure, ensure the TABs pay for it and don't pass on the cost to the punter.

3. 'Betting to Lose'

The Task Force appears to accord a great deal of weight to the proposition that somehow betting exchanges are, for the first time, allowing punters to take a view on a horse not winning and then concluding that the integrity of racing is fundamentally undermined as a result. This is a flawed view at many levels, for example:

- It has always been possible to profit from a horse losing. Backing the field against the horse makes it not just mathematically possible, but very much more difficult to detect. The Task Force acknowledges that mathematical possibility, in drawing attention to one of the few examples of such an occurrence being detected. The report states:

"An example of punters falling victim to foul play by racing participants was the Coloresque case. On 14 November 1995... Mr Gleeson's brother collected \$22,708 after boxing the field (minus Coloresque) in the Superfecta."

- Indeed, somewhat confusingly, the report suggests that a betting exchange could be a vehicle for skulduggery even without the ability to back a horse not to win, owing to the attractive odds being offered to punters. It is patently untrue that such an opportunity is not open to anyone at the sort of margins offered by the TABs, but the suggestion that it only works at betting exchange prices alone demonstrates a breathtaking disregard for punters' rights to get a competitive

price. This suggests further that the report sets out recommendations which merely protect and maintain the monopoly rights of the industry incumbents.

- The “Mr. Digby” example in the report exposes a worrying (even, embarrassing) lack of understanding of how a betting market operates. The example does not support the premise it is trying to support - indeed, it does completely the opposite. Its final sentence dismisses the myth that betting exchanges pose a new threat to the integrity of racing:

”By backing several runners in the race other than Mr. Digby.....the punter can achieve a greater rate of return than by simply laying Mr. Digby in the betting exchange.”

4. Prohibition: An Unreasonable and Disproportionate Regulatory Response

Even accepting that the Task Force could have reached a reasonable view on integrity issues, any independent observer would have to be struck by the lack of regulatory options considered in the report. Only one such option is considered – prohibition.

No real effort or thought has been given to sensible, commonplace regulatory measures that could be put in place to deal with the Task Force’s concerns. The Task Force has raced headlong toward a prohibition outcome because this appears to have been its intention from the outset.

To the extent that policy options have been developed (chapter 6.1), they all pertain to various facets of prohibition. An alternative public policy approach is clearly available, for example based on:

- A rigorous regulatory model (a preliminary framework for which was put before the Task Force by Betfair);
- Substantive three-way discussions on the detail of this regulatory framework between a particular state/territory regulator, the industry and potential betting exchange operators;
- Benchmark standards; and
- Applications and accreditation processes that would permit only betting exchange operators with the highest standards of internal processes and systems.

Betfair was, and remains, willing to have a constructive dialogue with Australian regulators about integrity concerns. As our discussions with the UK Government, UK industry and Australian industry have demonstrated, where legitimate and substantive concerns have been brought to Betfair’s attention, we have worked assiduously to deal with these in an open and reasonable way.

5. International Developments

The Task Force report makes a number of vague and ill-defined references to the actions or statements of governments, regulators and industries in other countries – with a strong implication that France, Japan, Hong Kong, the Netherlands, Denmark and the USA have come out strongly against betting exchanges. This is not true. The comments were only made in respect of cross-border betting and not in respect of exchanges.

Indeed, other than the UK, where betting exchanges are regulated as part of the overall betting industry, only Australia has thus far looked to address any regulatory concerns specifically about betting exchanges. All other comments have either focused on betting as a whole or have come from non-independent industry incumbents – that is, betting organisations protective of their market share.

6. Economic Impact/Characteristics of Betting Exchanges

The Task Force makes a range of unsubstantiated assertions and conclusions about the economic impact of betting exchanges. These are nothing more than ‘back of the envelope’ speculation by the Task Force, and should be treated as such. Specifically:

- Any pretence of independently-sourced, quantitative research or economic modelling has been disavowed in the Task Force report. Yet firm conclusions have been reached by the Task Force that are supposed to provide the basis upon which betting exchanges are effectively to be banned.
- Assumptions used in this ‘back of the envelope’ speculation are not always apparent (eg. extent and growth in ‘new money’ on Australian racing; churn rates etc). Where assumptions are stated, these are calculated to prejudice the betting exchange proposition.

For example, in relation to the product fees that Betfair might pay to the Australian industry, we have made it clear both on the public record and to the ARB that Betfair approaches this with an open mind and with no pre-conceived notion as to the appropriate levy structure in Australia. On this issue, we have never said that what applies in the UK must apply in Australia.

- The report states how much turnover it expects to move away from existing forms of betting to betting exchanges. However, it fails to provide any indication of how these numbers have been derived except to say that they are based on “*information available to the Task Force (including the submissions received from various stakeholders)[...]*”.

It is clear that those stakeholders have a vested interest in seeing exchanges being prohibited in Australia and it is extremely concerning that the Task Force has a) chosen to use their submissions as the basis of one of the fundamental conclusions in their report and b) failed to disclose the assumptions that underpin this conclusion. These two points raise serious questions about the conclusions reached.

- The report talks at some length about the potential impact on incumbent monopolist TABs, as if the likely loss in market share is somehow a disadvantage of the betting exchange model. Betting exchanges as a vehicle for competition and innovation should be considered a primary reason why the custodians of public policy should proceed from a pro-licensing/regulatory premise, rather than doing so from a conservative, pro-monopoly starting point.
- The Task Force makes the assertion that betting exchanges can offer competitive commission rates to punters because, in the view of the Task Force, they pay low levels of tax to government and minimal levies to industry. Betfair's low-margin business does not extend to paying a low level of tax or minimal levy. The belief that it does indicates a fundamental level of misunderstanding (or prejudice) by the Task Force of the betting exchange business model.

If there is a positive to emerge from the Task Force, it shows that the TAB monopolies are now on notice to lift their game. The punter has a growing uneasiness with the raw deal they get when betting on a TAB. Punters are looking for competitive and innovative alternatives, and will not respond well to TAB-instigated moves to punish them for doing so. The cost of prohibition will be very high.

The growth of the racing industry in Australia has not only stalled, but its share of the wagering dollar is in serious decline. When you consider that the engine of growth in the wagering market as a whole will come from new technologies, and that racing ranks only in “mid table” for these new technologies, it is clear that racing’s share of the market will fall yet further.

The industry must recognise that it is undergoing a structural change. New technologies, particularly betting exchanges which see racing as their principal sport, can bring to that new structure a level of innovation, flexibility and competition that will bring considerable benefits, and help racing regain lost market share. The Task Force does not just dismiss this; it fails even to consider it.

The TABs have a costly agency and commission structure that is under-utilised and designed to accommodate peak punting traffic. On the other hand, Betfair operates 24-hours a day on sporting and racing events around the world, with global efficiencies that allow it to offer better odds for the keen punter. This generates higher market throughput from which racing and sporting codes ultimately benefit through Betfair’s taxes and industry contributions.

The Betting Exchange Task Force report is a reductive and defensive document that seeks to perpetuate a raw deal on the Australian punter. The report is fundamentally flawed. It will sit uncomfortably if used as the basis of policy.

Australian Racing Ministers, the racing industry, the taxpayer and the punter all deserve better. But first they need to know the extent to which the Betting Exchange Task Force has let them down. That is why we have chosen to make public this correspondence to you.

Yours sincerely,

Edward Wray.