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Morning Session 3

**HOW SHOULD NORTH AMERICAN RACING
RESPOND TO EXCHANGE WAGERING WHEN THE
SHIP HAS LANDED ON OUR SHORES?**

Moderator:

Paul Estok, General Counsel, and Corporate Secretary, Harness Tracks of America

Speakers:

Eugene Christiansen, Chairman, Christiansen Capital Advisors, Inc.

Chris Scherf, Executive Vice President, Thoroughbred Racing Associations

Niall Wass, Betfair

MR. STEVE W. BARHAM: The moderator of this panel is Paul Estok. Paul is an alumni of the Race Track Industry Program. He is the general counsel and corporate secretary of Harness Tracks of America. Paul also is the liaison of that association for dealing with our students.

Tomorrow at the Idea Forum a number of students will be presenting projects they've done this last semester, and Paul is an integral part of that program.

So with that, Paul?

(Applause)

MR. PAUL J. ESTOK: Good morning. First off, both personally and on behalf of Harness Tracks of America, I'd like to thank Doug, the faculty, staff, and mostly the students of the Race Track Industry Program not only for putting on another wonderful Symposium, but also for the work they do throughout the year with HTA which has the benefit of being based here in Tucson, and which enjoys a relationship with the Program that allows us to interact with the students and the faculty, hopefully to benefit of both organizations.

Our topic this morning is exchange wagering; specifically, "How Should North American Racing Respond To Exchange Wagering When the Ship has Landed on our Shores?"

Person-to-person betting exchanges have revolutionized the way many people now place bets. They act as a brokerage allowing different customers to bet against each other. You can back your selection to win or you can back your selection to lose.

Anecdotal reports indicate that on average odds are about 20 percent higher when betting through exchanges than those offered through traditional bookmakers and/or the tote system.

A few of the exchanges you may be familiar with include Betfair, Sporting Options, Betdaq, IbetX, Trade Sports, Spinbet, Betmark and Betting Pals.

While the numbers are difficult to come by, suffice it to say hundreds of millions or perhaps billions of dollars are now being wagered through these and other exchange betting sites.

Today our panelists will look at the phenomenon of exchange wagering and offer some possible strategies and alternatives for you to consider. I believe it's safe to say there's a widespread belief in the racing industry in North America and around the world that exchange wagering poses a threat to the wagering now offered at racetracks, but within the past few months the notion has also cropped up that perhaps this form of betting offers more, that just maybe if it's as popular as we think, an opportunity is presenting itself that we should take advantage of.

Over the course of my brief tenure in the racing industry, speakers at industry meetings, pundits and more importantly our customers have talked about the notion that something needs to be done to reinvigorate the betting product.

Often the product they're referring to means the racing in terms of quality or presentation or structure. But the other product they've spoken of is the wagering itself. New bets have been tried in the past and continue to be implemented by racing organizations looking to reinvigorate the product, whether to offer newcomers to the racing experience ways to ease the learning curve or to offer hardcore customers options that acknowledge their likes and dislikes.

In the case of betting exchange wagering, perhaps it's time once again to listen to what the customer is saying with regard to wagering. Are there hurdles to getting these consumers what they want? Certainly there are. Bookmaking laws in the United States pose a formidable barrier to exchange wagering, I think we all know that.

And yet there are already those who have suggested that we need to somehow recognize what these customers are saying and find a way. Chris Scherf suggested

at the Simulcast Conference that perhaps American racing needs to explore the idea of an industry betting exchange.

Cantor Index, one of the exhibitors here at the Symposium, is promoting a new bet called the Group Bet that it sees as one legal alternative to exchange wagering. What seems clear is that racing is facing another challenge, and that meeting that challenge means bringing the opportunities as well as the problems it presents out and working on them with critical and creative thinking.

At this point we'll hear what our two speakers have to say. Following their presentations I'll invite Niall Wass, director of marketing of Betfair, to join us up here on the podium, and then we'll open it up to questions.

I encourage you to take this opportunity to open a dialogue by asking questions and airing out concerns or criticisms you might have on this subject.

Our first speaker today is Eugene Christiansen, chairman of Christiansen Capital Advisors. For his detailed biography I'd refer you to your Symposium program.

Suffice it to say he's worked in racing, gaming and leisure industries on many of the challenges they've faced over the course of his career. He's a co-author of the book "The Business of Risk," which I first read as an undergraduate and which I recommend to you as a necessary text for understanding the economic, social, psychological and political structure of legal gaming.

Gene?

(Applause)

MR. EUGENE M. CHRISTIANSEN: Paul, thank you very much. It's a privilege to be here as always. I'm going to run through a lot of PowerPoints. You don't have to take notes, this presentation is posted on our Web site. You can just go there and download it. This may work. That's the Web address.

So anyone who finds this interesting, just log on to that Web site and you will find all of this material. Betting exchanges are a topic that I think, as Alan said in the preceding panel, are just vitally important to the future of this industry. And as Paul just said, the reason they are important is that the customer has spoken and these businesses, especially Betfair, have just exploded.

My view of this is a little different from the preceding panel. I'm not going to look at this as a problem, what I'd like to do is sort of step back from this industry, look at some other industries that have also been affected by the Internet, and see what it says about the world and how the world has changed.

I sense a feeling in the room, and from the last panel, that there's a sentiment here that if we could just get rid of Betfair, we could shut it down, the world would revert

to its former condition, all wagering would go through the pari-mutuel machines and everything would be fine.

I have to tell you I think that's a fantasy. I do not think this is the case. Betfair is just an incident. What is really going on here is that the Internet has changed the way people relate to each other, the way they relate to goods and services. The world is not going to revert to its former condition, it's going to be different in the future than it was in the past, and what that means is that industries that survive will have to adapt, business models will have to change.

Some of these we'll go by pretty quickly. I think these are the responses that racing could adopt to the phenomenon of betting exchange. You could just do nothing. I don't think that's really an option. If you do nothing the outlook isn't good.

You could form a committee; that's something that comes natural to this industry.

(Chuckles)

You could adopt the "competition is illegal," or the Napster response. And as you'll see in this presentation, file sharing in the form of Napster hit the recorded music industry that was the instinctive response; competition is illegal.

In this case the law, the intellectual property law was not ambiguous. The labels decided to go into court and shut Napster down, and they did, and we'll see what happened. You could change racing's business model. You could adopt new lines of business to replace pari-mutuel revenue that is being sucked out of this industry to not only betting exchanges but offshore betting sites. That was the subject of yesterday's Racing and Gaming Symposium.

You could adopt VLTs. It's a possible response. All the evidence is that that won't do anything to increase the number of racing fans. But it is a response.

Or you could enter the market with a competing betting exchange service of your own. There are problems, as Paul has just mentioned, with that response. Or you could find some other adaptation of the existing U.S. racing business model.

But you're going to have to do something. Because betting exchanges and the Internet are not going to go away. What the Internet is doing, the Internet is realizing its promise, it's wringing inefficiencies out of industries and it's lowering consumer prices through more perfect information.

Those look like just words but that really is what's going on. This is affecting many industries, it is causing many industry business models to change, and across the board, it is lowering prices.

Some industries that are analyzed or presented in this series of PowerPoints include airlines, movies, music, travel and lodging, and bookmaking. In all of these industries the Internet is creating lower prices for the consumer, and in many

cases, new services, new ways to book airline seats, new ways to book hotel rooms. It's creating new businesses, like Napster, like Betfair, and it is impacting the pre-Internet businesses.

Music file sharing, I think you're probably all familiar with it. It's hard for me to believe that there is anyone in the United States that doesn't know about downloading music files. The music file sharing over the Internet, it's free, if it's illegal; it's more convenient, it offers vastly greater selection, and it enables listeners to hear the songs that they want without having to buy a \$16 CD album that has one hit and maybe 19 songs they don't want to listen to.

It's a terrific proposition to the consumer, and when file sharing became a part of life in the late 1990s, just a couple of years before Betfair was started, it took off like a rocket, and it changed the way consumers listened to music.

This is what it did to the recorded music industry, and if you think trends in pari-mutuel handle and attendance are bad you should look at this.

Following a decade which saw sales of recorded music, this is domestic recorded music, increase from about nine billion all the way up to 14.6 billion, sales of recorded music went into a tailspin. You had year after year double digit declines starting in the year 2000, and panic set in in the music industry.

This had never happened. The recorded music industry business model, the CD and before that the LP had served the industry well for more than half a century. The industry could not understand what was happening to it.

This is what did happen to the industry; you can see how people get music today online. Most of them, more than 20 million consumers are downloading files from free file sharing services, Grokster, Rhapsody, what have you, there are many of them.

A much smaller number are paying to download files. And a relatively negligible number are subscribing to pay music services.

None of this existed before the Internet came along. This is all new. The numbers, when you talk about more than 20 million consumers, the numbers are large. It is impossible to have that many consumers in this country change their habits without affecting the industry concerned.

This was the Napster response, where the competition is illegal response, this is what the labels did. They went into court and shut Napster down. That was in 2000. That did not, as you've just seen, reverse the decline in sales of recorded music.

So the labels went to the next step, they decided to sue the consumer. They instituted suits against file sharers. To date about 6,200 of these suits have been settled. But the effect of all of this, and again the law was not ambiguous, there

was absolutely no question that illegal activity was taking place, but the effect of this on CD sales is completely unclear.

In the first three-quarters of this year there was what looked like a modest rebound in sales of recorded music, they were up at one point about six percent year over year. But for the last 10 weeks it's been — going into the Christmas season it's been wobbling back down and into reverse.

And there is widespread fear in the recorded music industry that maybe the bottom is about to fall out of the industry. The consumer lawsuits, the suing the consumer, it did accomplish one thing. It took the quotation marks off the word "illegal" in the phrase "illegal file sharing."

This is extremely important, because the law in question is intellectual property law. And intellectual property law touches everyone. It is the basis for virtually all creativity and it is the legal basis for all industries; music, books, anything that deal in intellectual property, and it affects this industry.

Because as you saw in the last panel, one of the possible responses that racing could make to file sharing is to gather all of the intellectual rights, the intellectual property rights in racing, into a single hand or in somebody's hand somewhere, that could then deal with betting services globally in a more effective fashion.

In essence that's what the labels try to do by evoking intellectual property laws in the U.S. courts. They protected the rights that underlie their industry, and that was the one thing that I think this effort clearly did accomplish.

Let's skip the response in the movie industry, which is very similar to the response of the labels to file sharing. This is the world in recorded music as it exists today. These are all businesses. The first two, Kazaa and Grokster are free or illegal file sharing.

The next category are IAA licensed services starting with Apple's iPod and iTunes, these are download services that are licensed by the labels and return money to the recorded music industry. And there are some other responses.

Universal Music Group announced last month that they're going to launch a digital label that will publish music directly on the Web, bypassing the CD entirely. So what Universal Music is saying is that, "You know, hey, maybe the old CD business model has become obsolete. Maybe that's something that's going to wither and die, and we have to start experimenting with a new way to distribute our music, and generate revenues in the process."

What it all means is that the recorded music landscape today is very, very different; and what it means is that the music industry is changing and adapting its business model to some very different market conditions.

The same thing happened in online travel. The same thing. Happened on travel. You're all business travelers; I don't have to tell you that in 1995 if you wanted to go many places in the United States your option was U.S. Airways and the fares were very high.

The Internet changed that. It gave airline travelers, including business travelers, access to all business fares everywhere, it encouraged the development of the Expedia business and its competitors. Expedia is now under Barry Diller's Interactive Corp. They've purchased inventory from the airlines in block and discounted it to consumers. The end result was that airline fares came down, the end result of that is that U.S. Airways is, and a lot of the other carriers are, looking at bankruptcy.

This, I think, is worth stopping and taking a look at. These are U.S. households online. From nothing in 1995, now 62.2 million households are online in the United States today. That's not far below cable households, which is 72 or 73 million. And it hasn't stopped.

These are early days in the Internet. The process of change is far from complete. And Betfair, which is gambling's analogy to Napster, a business model that did not exist or did not work in the physical world but worked well online, is only the first of many changes that I'm sure the Internet has in store for this industry, for the music industry, for the movie industry, for the lodging and travel and airline industries.

It isn't as simple as saying, "There is one company out there by Napster, and if we could just get rid of it the world reverts to its former condition," and that is not what we're looking at.

So what can we do? I want to get off here, I'm trying to make a plane.

How could the industry react to the fact that betting exchanges are on our shores? Last month in Global Gaming Business I saw a couple of Jack Ketterer's, — and I think we can call it the "Ketterer Recommendations." I think they're worth looking at.

Jack Ketterer, who many of you know, his first possible response is that racing has to reduce the high cost of wagering that has caught up with the racing industry, because the driver of all of this change, not just in your industry but in other leisure industries, is that the consumer seeks lower prices.

This isn't wrong. And it's very hard to pass laws against it. Once the Internet made it possible for lower priced betting services to exist, like it or not, pari-mutuel operations have a competitor. And the competitor is not going to go away.

So what Jack was saying, if I can speak for him, is that we're under price pressure now as an industry and we have to find a way of getting our product to consumers at a competitive price. We can't maintain the old price structure.

That's what U.S. Airways tried to do, they tried to maintain their 1995 price structure and they couldn't do it, the Internet just shot it out from under them. And the next thing that happens is that you lose your business, you're in bankruptcy.

So I think this recommendation of Jack's is something that everyone in this industry should devote very, very serious thought to.

Secondly, demand a contribution to purses from non-racetrack sites to allow those sites to participate in the racetrack's pari-mutuel wagering pools.

I cannot say too strongly that I think that is important and I think that should be a centerpiece of any response of this industry to both offshore betting services and to betting exchanges, but I want to make a point: You can only do this when you're dealing with licensed, regulated services. You cannot do it with unlicensed, unregulated services because they're beyond your reach and they're beyond the reach of law enforcement.

You all know an analogous experience, you all know the experience with sports betting in this country. Bookmaking is illegal in this country because of the Wire Act. No one can recover money from unlicensed, illegal bookmakers because they are unlicensed and illegal.

The fact that there are millions of them and there's very little unsatisfied demand for sports betting in the United States are relevant. You can recover money from Nevada's licensed bookmakers. So that becomes an outlet where racing can sell its product and be compensated in return.

So while I think this recommendation of Jack's is good, it carries a corollary. It's only good advice if you're dealing with licensed, regulated services. I think that's an argument for trying to bring big companies under the tent.

You could reduce the number of racing days to a realistic number, I think I'll pass over that, it's kind of a different issue.

And breeders must produce racing animals that show enough potential to race and win enough purse money to show profit that they can still sell to prospective buyers. I'll pass over that as well; I think it's a different issue.

What should racing do? I think racing certainly should follow the first two of the Ketterer Recommendations. I think they're good recommendations. I think racing should not confuse the legal problem with the business problem posed by betting exchanges.

The laws against betting exchanges in this country or wherever, these are the concern and the responsibility of law enforcement. Racetracks are not law enforcement agencies, they are businesses.

Racetracks have a business problem, they have a problem of price competition in the marketplace, and the solution, I think, can only be found in the marketplace. And I would remind you that invoking the law, the legal response, shutting Napster down didn't help.

What helped was that Steve Jobs, an outsider to the labels came along. He said, "I have a new business model that's called iPod iTunes, and I can deploy that in the marketplace, and I can start to recover money from the download file sharing music phenomenon. iPod iTunes is going to download 150 million music files this year at 99 cents apiece, and it works. Because it works all the labels and Microsoft and a lot of other folks are setting up music stores online as well.

That is what I mean about looking for a marketplace solution to marketplace problems. Let somebody else worry about enforcing the law.

Change the racing business model, we've looked at that. Enter the market with a competing betting exchange service. That's my last point.

I'll turn the microphone over to Chris because Chris proposed this at a conference earlier this year. It doesn't seem to have excited much interest, but I think there's something to be said for that. I think there's something to be said for looking at that as well.

Chris, maybe you can come up here and talk about that.

I want to thank you very much for listening.

(Applause)

MR. CHRISTOPHER SCHERF: Thank you very much, Gene. And I found that very illuminating myself. It sort of articulated what I was — where I was coming from instinctively.

I need to start with a disclaimer. My views that I'm representing today are purely my own, they do not represent the TRA, nor any of its 41 member plantations.

(Chuckles)

"The exchange wagering master plan for North America." I probably should have a question mark on the end of it. We do have a plan and the plan is they're a threat. I agree with everything the previous panel said about the kind of threat that this poses to our industry.

It could bring it down; I mean, it's just that serious a threat. We could lose our funding, that's the basis of it. Our concerns, they'll steal our customers. They have stolen our customers. That's the nature of the Internet also, even Betfair, which does not except from U.S. bettors.

There are U.S. bettors betting into it because bettors are creative and they'll find a back door in, and there are other places, and we mentioned all of them. So they are stealing customers.

The biggest threat exchanges have is that they don't have to make any compensation to the industry. The beauty of the pari-mutuel system was it's a risk-free thing to be in a pari-mutuel business. You just take your money off the top, and then it's between the bettors.

That's what pari-mutuel consists of and the bettors assume all the risk, pari-mutuel operators assume none. To get into the business they pay fees. The offshore places that have contracts with us to get into our pools are paying fees, we're getting some compensation for that.

Illegal bookmakers or Internet bookmakers, they didn't. They could be in business, they didn't have to pay us, but they had to assume the risk, and that always depressed that business. And particularly the big bettors.

When Vegas booked bets in those days, they had limits, very strict limits on what they would accept, what they would pay out. It was the same on the Internet. It's a very simple thing.

You all know the big offshore places that are coming into your pools, you see the negative settlements. Do you think these places would be in business if they had to book those bettors' action? Not more than a week.

Threatens the integrity of racing, I don't need to go into that.

It's unfair competition, it's lower priced. And it's fixed odds and all the things our fans love, and that's not fair.

It's illegal activity, you know, and we're hoping that that will have some effect.

I'm going to go back. Most important it's going to kill racing, it's going to create a critical loss of business, it's going to destroy the sport's integrity, it's unmonitored and uncontrolled wagering activity. Everybody that's betting on exchanges now, we have no idea who they are, we have no idea what they're doing.

And the last point which is a very important point, remember these Internet bookmakers that assumed risk? These are handy-dandy devices for them to become clients of exchanges, balance their books as best they can, and suddenly it's not as risky for them. So exchanges could help all the Internet bookmakers go into the horse business with much less risk, which is more competition for our patrons because they'll accept wagers and clients from anywhere. They're not shutting off U.S. bettors.

So what are we doing about this in the United States? Well, we talked about international enforcement of U.S. laws, the International Federation of Horse Racing

Authorities and their Good Neighbor Policy, we're joined in that, we're hoping that the rest of the world will ride to our rescue.

The problem with that is betting exchanges are legal where they're occurring, they're not against the law. Those governments have made a decision they don't need to enforce U.S. law. You have Antigua and the United States before the World Trade Organization and it found in Antigua's favor on that issue.

So the question is how effective will relying on the international community be in keeping U.S. bettors from going on the Internet and betting with someone who offers them a better price?

Second is U.S. control of the Internet. Now, the United States Government has been trying to control the Internet since its inception, and it has proved a slippery rascal; the porn industry, unconstitutional. Internet betting, how much Internet betting is going on from the U.S.? Just tons of it.

Even SPAM, you know, we have a law trying to outlaw SPAM. It's still around, it's just almost impossible by its very nature to control the Internet.

It's extraterritorial from every jurisdiction in the world. Furthermore, we have federal legislation that's pending that would control credit applications towards gambling.

Our biggest concern as an industry has been to keep our exception for legalized betting; my point about the entire Internet bill has been the day after it's passed, if it's ever passed, and it's been at least five years that this has been trying to wend its way through Congress, and you have U.S. bettors betting with illegal Internet bookmaker sites offshore, what has changed once you pass that bill? Government can't reach the source, and until they pass laws that say they can monitor everybody's private computer, those places are going to stay in business.

I guess a third possibility is we could all get together and we could write a strong letter to the Times.

(Chuckles)

Now, the point I'm coming from is we've heard why it's a threat, why we have to stop it. But if you don't have absolute faith that items one or two are going to be able to do it, I guess we're going to have to revert to the industry's Plan B. And what is Plan B? We don't have one.

(Chuckles)

Oops? So if we're going to come up with a Plan B, what are the core problems? Exchanges are a more efficient market, you can strike a deal at a set price and value. Pari-mutuels are horribly inefficient. They were created in the 1930s because

that was the best we could do at that time when we were going to outlaw bookmaking.

As a result, when somebody makes a bet they do not know what price they are getting. We go to a stock market, we say we want to buy Cisco at 19 and a half dollars, we're buying it at 19 and a half dollars. We will know what we perceive the value to be, we know what we're going to pay for it.

We ask people to bet on something and say, "Well, we can't tell you until later what the price actually was that you paid." How many people have ever bet on a 2-1 shot and when it goes off he's even money? Not what you wanted to do.

There's no other part of your personal life where you make those kind of blind purchases, and that's what we're asking people to do with pari-mutuels. And if they think that there could be a better way of doing it, now they're right. Exchanges are a better, more efficient way of doing that.

Second, they offer lower commission rates. I mean, how many — do we want to do a poll of your track patrons and say, "How many are in favor of paying higher rates?"

Third problem is the public likes number one and number two, they just think those are Jim Dandy things, more efficient. I know what I'm going to get my price when I buy the bet and I pay less for it. That's our biggest problem, they like that.

So what we going to do about it? We're either going to try to stop it, or is there any way we can live with exchange betting?

And let me say right now I'm not saying we can't or we can, I'm just saying there should be a dialogue, there should be a priority within this industry and we should be trying to decide where we want to go on this, trying to come up with a way that maybe we could live or compete in the exchange business, one has become the monopoly supplier in the U.S. of exchanges.

Is that possible? There are arguments against all these things, I'm not ever saying any of that is easy, but we do have legalized monopolies, we still have them on pari-mutuel wagering. You know, you determine who comes into your pool. And it's state-granted, you're the only one in your state if they want that's going to be in the pari-mutuel business. They decide who's licensed to do it.

States still have great control over who does it. The complication of course, of that is still the Internet, it's not governed, you're still going to have to deal with that aspect. It's a variation on the theme of pari-mutuels, it's betting among ourselves, it's just more efficient.

Now, some people say you're really kind of stretching that. That's not true. And how — you're never going get any legislature to buy into that argument because that's too big a stretch.

Has anybody ever seen a slot machine at an Indian casino? They're not slot machines. They're lotteries. They sold it on the concept that these are lotteries. You know and I know they're slot machines, the Indians know they're slot machines, but they made the argument they made effectively, they made it persistently and they made it persuasively, and that's what it is.

Now, this is more a reason to say that betting among ourselves is pari-mutuel, it also can be exchanges. A key thing to a successful exchange — and when we have Niall up here you can ask him about that — what makes Betfair so effective is, A, they're the first to market in a large way that captured much.

Liquidity. For an exchange to work, whether it's betting, whether it's anything else, there has to be liquidity. You have to be able to go to the market and you have to be able to sell or buy at a certain price and have someone on the other side willing to do that transaction with you.

First-to-market is key to liquidity; there is no market in the U.S., we have narrow window of opportunity, I believe. It's a new complementary wagering product that includes fixed odds wagering. If there's a bigger complaint in this industry today than the way odds change after a race goes off, I don't know what it is. That's got our customers in turmoil. "I didn't buy the bet at that price."

We can't figure a way pari-mutually — and I've been coming at these things for 20 years — to get fixed odds into this country.

You can, and Australia they have legalized bookmaking, they can offer fixed odds as an option. I believe — I know our bettors would love to be able to better know what they're buying at the time they buy. We would need to create a beneficial business model.

I would totally agree if the commission Betfair or anybody has is two to five percent, then we're going to lose some business to that and we're going to take a percentage of that two to five percent, we can't subsist on that, but that doesn't mean we can't come up with a different business model and a different pricing model.

I mean, what we're competing with here with ourselves is a 20 percent takeout. Can we build a business model? I don't know. But should we be looking at it? I think so.

Monitor wagering activity. The integrity issue is real, and this probably heightens it but it does have some side benefits. Can you monitor it? If you were the sole source of legalized exchange betting in this country, you would have a much better way of monitoring it.

I guess one of the detractions of simulcasting has been it's made it more difficult to monitor wagering activity. But you talk about betting a horse to lose, it's happened.

Unfortunately I'm old enough to remember when Tony Ciulla made the cover of Sports Illustrated, fixing races up and down the East Coast, fixing trifectas. This was to keep the favorites out of the top three; that was a pari-mutuel system happened.

It also is easier if you have complete records of where transactions are taking place to sort of see when something suspicious is happening. That's disappearing with simulcasting when you've had 800 to 1,000 outlets that you can spread your money through, it's hard to see a lot of play out of one place. There's a lot of ways to camouflage these days.

You can't really trace the money. You would control the accounts, you would have total access if the industry had its own owned betting exchange. They would know who the accounts are, they would be able to monitor it, monitor the players.

And the last one, customer satisfaction. This is the one, even if I think somehow we could stop betting exchanges, rid the world of betting exchanges — well, rid the world of Internet — you still have the problem with just summarily dismissing the idea that, why don't we give the public something that they would like? Give the customer what he wants, keep the customer satisfied: Those are rather fundamental business principles.

Now, when I made my comments at the Simulcast Conference of September, I think some people thought they'd be very controversial and they said, "You know, what kind of feedback have you gotten back from the industry?"

Well, I've gotten a lot of e-mails from a lot of betting exchanges internationally. I'm their best friend, and I don't understand why. Because I'm not talking about opening the U.S. to them, I'm talking about, we have one and we lock them out, but they want to have the dialogue.

I've had other people internationally; I had a friend from Australia who — now a friend, I didn't know him at the time. When I got back to my office and my first e-mail was, "Chris Scherf is an idiot."

(Chuckles)

Sent around the globe. But I've been called worse. But within the U.S. industry there's been no reaction.

We just had an international panel tell you this is the biggest threat to our industry. Now we have this panel saying this is something that needs to be done with, dealt with; we're just sort of sitting and listening.

And I think we may, instead of controlling our fate, just see what happens. We did that with eBay. In 1999 I came to a TRA board meeting at this site and I said,

"We're starting rebating and we're starting down a slippery slope, and it's time to take control of this before it gets out of control.

Witness now it's a significant part of handle, it's a significant part of customer expectations and we didn't control it, we let it control us."

Same thing is going to happen to exchange wagering, and that's why I think we have a narrow window. I'm going to ask the TRA board tomorrow to make this priority to at least investigate what the options are and come to a conclusion in 2005. We need to have a debate within this industry and need to have it now.

There's two ways you can come out on this, and maybe the best one should win, but it shouldn't be because we just didn't care and we let somebody else decide. You can try to keep exchange wagering out of the U.S. Then this industry should decide what is an effective strategy for doing that. And have a defined strategy. And what resources are we going to commit to it?

Versus try to monopolize exchange business and try to build a business model, try to get legal recognition for that business model monopoly and try to capture the liquidity before anyone else does that.

This is something that's vital to all of us and is something that we just can't wait for the other guy to fix. We need to be part of the solution. So that's my advice to this group, to the industry. I offer it with a caveat that, "Chris Scherf is an idiot."

(Chuckles)

And I think I'll open it up to you now and ask Niall to join us up here from Betfair, who certainly knows more about the exchange business than I do.

(Applause)

MR. ESTOK: Thanks, Chris. Niall, if you'll come up.

If anybody has any questions, I'd encourage you to ask them now. This is your best chance. We're relatively short on time so I'm not going to push this.

Niall, I have a question for you, I'm going to put you on the spot real quick here. If you put on the U.S. racing hat, what do you think our response should be to you?

MR. NAILL WASS: Well, I think Plan B as it's being called is actually to engage with an exchange company. And I suggest the market even makes sense; but I would say that, wouldn't I?

I think you've got to establish the integrity agreements as we've established in the UK, we're sincerely prepared to do that. I think we need to, you need to create the appropriate funding structure, and I don't think we should be focusing too much on the fact that we talk about two to five percent in other countries.

There are many different ways of slicing it, and certainly we at Betfair would be open to changing the commission structure if that made more sense to this market. And I think what you have to do, and this point has come across very strongly, which I think is very interesting, is give people what they want.

And we've done research in the U.S. and talked to an OTB with repeat shoppers and asked them what they were thinking of the betting exchanges. And there's been overwhelming positive response. Not only that, they have said that they would increase their spend by being allowed to play horses.

What an exchange is doing is creating a different type of bettor as well; so you're encouraging more people back into the industry, people who are not placing one bet per race, but who are actually placing many different bets per race.

And you look at the profile of our bettors we're getting people placing now sometimes up to a hundred bets per race.

So the other thing to add to that is 60 percent of our users are less than 40 years old, so we're attracting a younger type of person into this as well. And I think what the U.S. industry needs to do is to do something for the consumer, and actually recognize that exchanges can be what they want.

What you need to do is make sure that you engage with somebody who is prepared to stand up and play the legal route, because there are 40 exchanges out there right now; many of them are taking bets from the U.S. right now, and many of them will not be prepared to engage with the industry.

So I think Chris' point is valid, which is, "Let's make sure there is some level of control." So my advice is regulate and license a small number of betting exchanges. That way you will get all the benefits from the exchange model.

MR. ESTOK: Thanks. Go ahead?

MR. ANDREW MACDONALD: Actually, this comment is for Betfair. You were advocating going the legal route.

In Canada we've had a different experience with you; it's illegal in Canada, yet you continue to operate there offering Woodbine product to Canadian citizens according to a letter that we received from you.

In addition to that, you've operated seminars within an hour or within a mile of our racetrack soliciting customers. Yet you're saying that you want to work with us?

So basically you're bringing a gun to the negotiating table and holding us at ransom while you're still taking our customers, asking us to believe that you want to work with us?

MR. WASS: Okay. Well, I mean, thank you for that.

(Applause)

I mean I think — it's up to people to — you know, dialogue involves two-way communication. And if it's just a case of you guys sending us letters saying we can't operate. My understanding of the Canadian law — and I'm not an expert on it — is that we can take bets from Canada but we cannot advertise in Canada; you must correct me if I'm wrong on that.

But you know, the offer stands with all countries is that we are happy to negotiate and come up with the right solution for each country. You know, we've seen a very fancy video about Australia.

The question I had is; Betfair's been operating for two years in Australia. Has that damaged the integrity of Australian racing? I don't think so. We are now engaging with the authorities in Australia and will continue to do so and be happy to do the same in Canada or the U.S. or wherever of it may be. But that requires other party to come and talk to us or at least be open to discussion.

MR. MACDONALD: Sorry, it was a two-part. The first, I don't know how we can be engaged in a discussion while you continue those activities, and we made that clear.

The second is: From those Canadian accounts betting on Canadian products you alluded earlier that all this money is going back to the industry. How much of that went to —

MR. WASS: No, I didn't say it was going back, I said we would be prepared to construct the right agreements for it to go back

MR. MACDONALD: Sorry, I thought it was going back, but in your case to the U.K. So in terms of Canada or Canadian residents were involved betting on the Canadian product, how much of their wagering activity went back towards other Canadian industry, Canadian involvement —

MR. WASS: It doesn't at the moment because we don't have an agreement, that's what we're seeking to do. Therefore I'd reiterate my point which is if people are prepared to talk to us we're prepared to listen and come up with the right agreement, but if you don't talk to us how can we do that?

MR. MACDONALD: So if we don't talk to you you will continue to pursue an illegal activity in our —

MR. WASS: Well, it's not illegal, it's not illegal. It's not illegal currently for us to do that.

MR. ESTOK: Okay. Do we have any other questions?

MR. MARZELLI: Alan Marzelli, moderator of the previous panel. I'm going to lob a few grenades up there. First of all, I hope the rest of the U.S. racing industry understands that Betfair is taking bets on U.S. racing product. When U.S. racing product is simulcast legally into the U.K. it is offered on Betfair, and U.K. citizens can bet on it and no revenues are returned to the U.S. racing industry from that.

But that's not my point, that's just a small grenade.

I agree with most of what you said, Eugene and Chris, as far as a Plan B. I hope when you go to your directorate tomorrow your Plan B begins with, number one, the reason we are in this dilemma is because we are operating on an antiquated technology infrastructure. We are lacking leadership in migrating to a new technology platform. We know what needs to be done, we need the leadership to get there. And we have lost control of our business as a result of it.

And that is what all of the other intellectual property businesses did along the way. We need to find that control, and the way we find it is to upgrade our wagering systems.

Point number two I would hope in plan B is that we respect other jurisdictions' rights around the world. This is an international problem, they all have their own problems to deal with and are looking to the U.S. for leadership, not for us to go it alone.

Thank you.

MR. SCHERF: Alan, I'd just like to respond for a second. A new tote protocol will address a lot of the integrity concerns of at least not being able to monitor action where it's coming from right now. It still leaves us on a pari-mutuel system that does not offer our customers everything they would like and that is a fixed odds betting environment.

MR. ESTOK: Mike, do you have a question and microphone.

MR. MICHAEL D. SHAGAN: Michael Shagan, sometime industry consultant. I've sort of been flat on my back from illness for the last year, and was heavily involved in these debates at that point, and it's interesting to see what's happened since.

A lot of the private discussions are now very fortunately becoming public. I want to make three points, in no particular order, and because Alan mentioned the rights of the industries in various countries to be upheld.

I think that's an extraordinarily important point. And so I think that any solution must be based in part on international agreement. Whether or not a Betfair is prepared to go along with the moral persuasion of a racing industry of a particular country where the laws are ambiguous in that country is not the issue. The issue is whether the racing industry will permit somebody like Betfair to bypass the industry

for a technical legal reason where the issue is not fraudulent integrity but integrity as an industry is at stake.

Secondly, Gene Christiansen made a key point, which is the things like the Internet are not going to go away and we can't just say, "Gee, we wish it wasn't there."

But there's a broader point that I would make that has to be in any solution, and I don't see it even in the international promulgation of these two points. And that is that the industry must and should have the right not to have its opportunities for expansion limited, to the extent that we can do so.

If a Betfair is prepared to pay 10 percent of 15 percent as a takeout, that's one and a half percent, that's not enough. What is right is whatever the industry needs to survive and prosper.

A lost opportunity for it to move forward is a key. And therefore the industry must stay to being on that basis.

And thirdly, I believe that the industry in each country and then internationally must set minimum standards. It can be done through racing commissions in this country, it should be able to be done on an international basis. And that minimum standard must clearly include the IFHRA points about how, if an industry says that no one can take bets on our product without the agreement of our stakeholders, then that must be honored. There was an Australian statute in Queensland and a model in Australia on that Australian basis. Where I objected and some others objected was that it then said, "But we can poach on other industries in other countries without their permission."

If they had gone further and just added that one clause it would have been an absolutely perfect model, but they didn't do so. And I'm glad that there's an international federation that is looking at this on a multi-national basis.

So my question to the gentleman from Betfair, is: Why, if you're not taking bets from the U.S., for whatever reason, you are taking bets apparently from Japan and Canada and other countries where some of the same legal moral industry positions are being maintained?

MR. WASS: Okay, I'll see if I can pick up both of those points. I think — as I said, I'm not an expert in the law. My legal advice we've been given, especially — we'll use Canada, for example — is that it is not illegal for us to take bets from Canada, in Australia we've been operating for two years as I think Andrew mentioned earlier, we haven't — the federal government has not changed its mind, we can legally operate there.

You know, I think the first point was around the rights of the industry, and whether they should be bypassed. I think there's a huge opportunity here in the U.S. racing industry, and it's time that somebody stood up and grabbed it.

You know, as was mentioned before, things will be pushed offshore; there are already exchanges operating offshore. You need to engage people who are prepared, and we are standing and have said so for a couple of years now, that we are prepared to engage and discuss with people and come up with the solution.

So we're not intending to bypass the rights, we want to find the right solution.

Your second point, I think, was around funding. One of the pieces of analysis we did is we looked at Youbet's average revenue per user, close as Betfair's on U.S. racing, and what we found is that from Betfair average revenue per user is about \$222 and about \$30 from Youbet. So, you know, I think we need to get away from the point that there is not a model that works for this industry.

We can find a model that works with this industry, that does return adequate revenue, that does fund the industry, that does compensate the horsemen's groups appropriately, and we are prepared to do that.

And I think finally, just to reiterate my point, racing's share of the gambling dollar, if you like, has declined, and I think the new technology that you referred to, the only part that's really coming up now at the moment is the exchange platform. This is the only new technology that really has racing as its number one business.

So I think it should be embraced. It's the customer who's paying, remember, and it's the customer in our research that is saying this is something that they want.

Betting exchanges are attracting different types of users. People are looking for value, yes; but also people who are what we call market traders, they're trading in and out of a position, they're hedging on a position, international players as well. The three main issues around licensing, integrity and funding can all be addressed, and I think I've tried to highlight those already, so I won't repeat myself.

So my final words to you really are, don't let the opportunity slip away.

MR. ESTOK: I think way have time for one more question.

MR. CARLOS KHOUZAMI: I am Carlos Khouzami. I want to thank Chris Scherf for the business-oriented way to tackle the problem you offered. I appreciate it because I believe this is the clever way to tackle the problem; nevertheless, with all the respect I'd like to challenge a little bit the Plan B you proposed.

You spoke about the fact that customers like to know the price they're buying at. In fact, this is fixed odds, as you said, and the country with fixed odds we're most involved with is England. And there's very strange things developing in England for some years which is SP, starting price.

In most of English customers today don't know the price they're going to be paying at when they take the bet, they take it as SP, starting price, which is very similar to

what pari-mutuel price can be. So it seems that this evolution is totally appreciated by most of the English people.

The second point is about the price. Now, it should be going from the cost price, which is maybe not the right thing to have a good, I'd say product efficiency, but on the other hand, Betfair is getting out saying the product is going to cost this price. The problem is that Betfair never tried to run high quality races with set amounts, and I believe it's impossible.

And the problem is then that we can take profit on these high rates at the time that they exist and then after when they're going to disappear because the money's not enough, well, the company like Betfair can go out and bet on some other things, while most of us are committed and limited to the races, and that's very important for us.

On the other hand, we had the discussion about Betfair two years ago, it's not a mystery. And they refused to change anything that their price structure. So I'm a little bit surprised to hear today that in fact they can accommodate. At least in France they refused to. Thanks.

MR. ESTOK: All right. One more question? Okay, one more real quick.

MR. BOB McREAVY: This will be very brief. My name is Bob McReavy and I'm with the Canadian Pari-Mutuel Agency in Canada. And we regulate betting in the country of Canada. I just wanted to — for the record I wanted to say that Betfair is not licensed nor approved in any shape or form to accept bets from Canadian citizens and I just wanted to have that on the record because I hear that you are saying that that's legal. Your advice is different and I —

MR. WASS: Our legal advice is —

MR. McREAVY: I'm just saying we are the only ones that regulate or approve betting from Canadian citizens, and we have not done that.

MR. WASS: Okay; thank you.

MR. ESTOK: All right. With that I hope you'll join me in thanking our panelists.

Thank you for being here.

(Applause)