

**Josh Blanksby**  
Director, Legal and Corporate Affairs

Ms Lyn Beverley  
Committee Secretary  
Joint Select Committee on Gambling Reform  
PO Box 6100  
Parliament House  
CANBERRA 2004

23 August 2011

Dear Ms Beverley

**Joint Select Committee on Gambling Reform (Committee)**

I refer to the Committee's public hearings that took place in Melbourne on 11 August 2011 and specifically to Betfair's appearance before the Committee.

Betfair took a number of questions on notice from members of the Committee and we below outline our detailed responses to those questions.

**Mr Steve Ciobo**

**Is there any difference between credit card companies offering frequent flyer points as opposed to online wagering operators offering inducements/credits to new account holders?**

Betfair is of the view that wagering operators should be permitted to offer low value benefits to wagerers to encourage them to perform their wagering through a regulated betting account, rather than in a cash environment or with illegal offshore operators. Our submission to the Joint Select Committee outlined our position that inducements could be limited to a value of \$50. As we outlined in our submission and in our appearance before the Commission an account based betting system provide benefits for the provision of responsible gambling, integrity management and fraud/AML. Customers should be incentivised to move to an account based system and away from cash betting.

Companies in a large range of industries offer benefits designed to attract customers, including credit card companies via the use of frequent flyer points. In our view, regulated wagering operators should be treated no differently, provided the benefits offered are reasonable in nature.

**Provide a copy of a report referred to by Mr Andrew Twaits, CEO of Betfair, prepared by Professor Henry Ergas in 2007 for the purposes of Betfair's case against Western Australia in the High Court.**

Professor Ergas provided a report to Betfair for the purposes of Betfair's case against Western Australia in the High Court. The report was contained in an email addressed to Gilbert & Tobin, Betfair's legal advisers. A copy of that email is attached to this letter.

**Senator Nick Xenophon**

**What is the level of commissions that Betfair has paid to its customers through its Refer and Earn program?**

As was outlined by Mr Andrew Twaits to the Committee, Betfair conducts a "Refer and Earn" program (<https://referandearn.betfair.com/au/home>) (Program) that rewards current Betfair customers for introducing their family and friends to Betfair. The Program works in a similar manner to typical refer-a-friend loyalty programs conducted by an array of business across a number of industries.

Contained on the Program's website is:

- (a) a detailed explanation of the Program, which outlines how the Program works for both referring customers and the friends whom they refer to Betfair;
- (b) the Program's terms and conditions; and
- (c) a template that details to rewards paid by Betfair to both the referring customer and the referee under the Program. This template fully discloses the amounts paid to all parties in accordance with the Program.

Betfair does not provide rewards on the basis of customer losses. Rather, rewards are calculated on the basis of "Betfair Points" accrued by the new customer in the period following registering a new Betfair account. Betfair Points are a measure of a customer's activity on Betfair and recognises both winning and losing bets. Importantly, more Betfair Points are earned when a customer places a successful bet. Accordingly, the Program operates such as to best reward customers who refer friends who are winning customers.

**What is the framework surrounding the triggers that alert Betfair staff to a change in customer behaviour?**

Betfair has rigorous systems in place to monitor alterations in customer behaviour. These tools are primarily used to monitor and prevent fraud and integrity issues on the Betfair platform, but are also able to be employed for the detection of problem gamblers.

All of Betfair's monitoring occurs on an exceptions basis. Our reports detect customers who win or lose more than would be expected based on their previous account history (both immediate and long-term history). Betfair is also able to break-down this information on particular sporting or racing events. This allows Betfair to not only identify activity of concern that is profitable but also where unusually large losses are suffered.

Betfair also analyses the funding of new accounts in circumstances where significant deposits are made compared to that user's profile and their access and betting history. Steps are taken to contact these customers to ensure that no abnormal activity has occurred. Such deposits are also investigated using various online resources to ascertain further background on the user such as their source of wealth to ensure that the funds that have been legitimately deposited using a deposit means that is controlled by the customer.

Importantly Betfair is able to implement the above processes due to operating an account based system where all deposits, withdrawals and bets can be attributable to a customer and monitored.

**Mr Andrew Wilkie**

**Is there a disparity between the proportion of Betfair customers who are Western Australian residents (where there are no electronic gaming machines outside the casino) compared to the rest of Australia?**

According to ABS figures (current as at 30 June 2010), Western Australian residents represent approximately 10.2% of the Australian population (2,296,411 of 22,342,398).

There are a number of reasons why there may be proportionally fewer customers in Western Australia compared to the rest of Australia, including:

- (a) Betfair's advertising is predominately focussed on the eastern states as the majority of Australian racing and sports events are held in those states; and
- (b) Racing and Wagering Western Australia (RWWA), which is both the operator of the monopoly totalisator and the regulator of the racing industry, has actively campaigned WA racing clubs to not engage with Betfair or any other wagering operator in relation to sponsorship arrangements, and has run a high profile "bet local" campaign.

**What is the volume of money traded and the number of active customers on election betting conducted by Betfair?**

There was a total volume of \$2.3 million traded on the outcome of the election itself, whilst a further 73 markets (primarily individual electorate markets) accounted for \$97,000 in wagers.

**Conclusion**

We trust that the above responses adequately address each of the questions raised by the Committee. Please don't hesitate to contact me if you require any further information or clarification.

Yours sincerely

Josh Blanksby  
Director, Legal and Corporate Affairs

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**From:** Ergas, Henry  
**Sent:** Saturday, 1 December 2007 7:24 AM

**Subject:** RE: Betfair submissions

hi

I have read the documents, and must say, I find the discussion of two-sided markets in the WA document slightly puzzling. I haven't yet had a chance to discuss it with [redacted] and his views may differ from mine, but my (very preliminary) views are as follows.

As a general matter, I agree with WA that betting exchanges have a 2-sided element; however, I don't think they have characterised it correctly. In effect, they characterise the two sides as being the event organisers and the punters – but it seems to me that the event organisers are more like concert organisers who sell rights to concerts to TV stations (though in the case of racing events, the "rights" seem to be sold for a share of the betting entity's takings): that is, they are input suppliers. There is certainly an element of interdependence, but it isn't clear to me why that interdependence alters the analysis.

They suggest that that interdependence gives rise to two sets of problems. The first and most obvious are the claims that Betfair might "free ride" on the event organisers, not contributing (or not contributing adequately) to their costs. I am not sure this is much of a 2-sided market argument: it seems to me no different from, say, the issues that arise when a competitor can freely retransmit concerts that have been paid for by another broadcaster. Moreover, to the extent to which that is a problem, presumably it is best dealt with by requiring Betfair to have an agreement in place with the event organisers if it wants to take bets on their races.

The second is the claim that Betfair will undermine the integrity of racing, and hence reduce the demand for betting services. However, even were this correct (and I will suggest below that it is muddled), it is not a claim that requires a 2-sided market kind of analysis. Presumably, it is no different from saying that greater consumer uncertainty about the quality of bananas at a fruit shop will reduce retail demand for bananas and hence will reduce the price and supply of bananas at wholesale in the long run: uncertainty about the quality of races will reduce the demand for betting on races which will reduce the flow of income to races and hence the supply of races in the long run.

To my mind, the proper analysis of the situation is somewhat more subtle. As I understand it, Betfair operates a "matching" service, in which they match a person willing to bet against an event occurring with a person willing to bet for an event occurring. (Indeed, the Betfair rules seem to say a bet will only be accepted if it is so matched). Now, this distinguishes Betfair from conventional betting, where the bet against is placed by the book-maker. It seems to me that two points follow.

First, this makes Betfair similar to what we call a "broker market" in securities trading, as compared to a "dealer market". In a broker market, intermediaries (the brokers) organise trades, but do not trade on their own account; in contrast, in a dealer market, the dealers provide liquidity to the market by trading on their own account, i.e. by operating a book in the securities they buy and sell. Broker markets compete with dealer markets, though most bourses have elements of both.

Second, it seems to me that this broker character gives Betfair an especially strong incentive to monitor and enforce the integrity of its trading -- i.e the exact opposite of what WA asserts. In

effect, in all markets that match buyers and sellers, there is what is called an "adverse selection" problem. (Adverse selection is a term from insurance. It refers to situations where the insured has information about his or her own risk that is not readily known by the insurer. In that case, when the premium is set so as to be actuarially fair for the averaged insured, the insurer may infer from the mere fact that a person wants insurance, that that person has above average risk, and hence may want to increase the premium; but obviously, any increase in the premium will drive away the low risks, and hence leave the insurer with a poor quality pool.)

In bourses and exchanges, "adverse selection" occurs when potential buyers of a risky claim face the risk that the claim they are being sold is being sold to them by a seller who has special information. For example, if I am in the market for BHPB shares, and you present and are willing to sell to me at the current price, I would have to worry that you know something about BHPB that I don't. The greater that risk of "asymmetric information" is, the bigger will be the bid-ask spread that I require before I will engage in the transaction. For example, if I am worried that you are selling because of inside information, I may require that it be possible to sell BHPB shares at \$2 before I agree to pay you \$1 for your shares, so that if the market turns against me, I have a buffer that protects my investment. However, large bid-ask spreads make markets inefficient, in that they suppress all the transactions that would have occurred had the valuations of buyers and sellers been more closely aligned. By doing so, they also make the bourse or exchange thinner and less profitable. As a result, all securities markets implement rules that are designed to limit the risk that I will be trading with what is called an "informed trader", i.e. someone who has information relevant to the value of a security but not known to the market. (Comprehensive discussions of these issues can be found in any book on what is called "market microstructure theory" – one of the most accessible, in the sense of non-technical, is Larry White's Markets and Exchanges.)

Now, in Betfair, bettors will worry (just as traders in securities markets worry) that they are betting against an informed trader. When they do so worry, they will alter the odds they post so as to protect against that risk – exactly as traders in securities markets adjust the bid-ask spread. That would obviously be costly to Betfair, as it reduces the aggregate value and volume of betting and hence the income it obtains.

In short, to the extent to which Betfair needs to match buyers and sellers of risk, the danger of dishonesty on either side of the market will directly affect the extent of trading on Betfair and reduce the income Betfair can obtain. As a result, ***precisely because Betfair is a 2-sided market that matches buyers and sellers***, it will have strong incentives to maintain the integrity of its platform – which is quite the opposite of the inference WA draws from the market's 2-sided character.

Moreover, the greater the risk of that integrity not being enforced, the more attractive it will be for punters to shift from the broker market to the dealer market (since the characteristic of this dealer market is a series of regulations aimed at preventing the dealers from affecting outcomes). In other words, were WA correct that (1) there are effective regulations in place that prevent its registered bookies from manipulating outcomes, and (2) there are not effective regulations in place that prevent traders on Betfair from manipulating outcomes, then it follows from rational behaviour that (3) punters would shift from the broker market (where they might be matched with a dishonest counterparty) to the dealer market (where the effectiveness of the regulations prevents that occurring). As a result, competitive pressures should lead Betfair to seek to pretty stringently protect the integrity of its betting.

I expect where I have come to can therefore be summarised as follows:

(1) WA characterises the market as 2-sided because of the links between the punters and the event organisers. This is making the relations between these unnecessarily complicated: the reality is that event organisers essentially provide an input into the product supplied by the betting suppliers. To the extent to which there are issues about the terms on which the event organisers sell those inputs to the betting suppliers, those issues could readily be dealt with in a non-discriminatory

way, for example through requirements for the latter to have agreements in place with the former.

(2) However, WA is correct in saying that the market at issue has a 2-sided element. That element arises in the betting exchange's matching of bets on outcomes with bets against outcomes. In the conventional structure, the bets against are placed by the book-makers, who are like dealers (entities that trade also on their own account) in securities markets; in a betting exchange, the platform is merely a broker, matching counterparties with offsetting bets.

(3) That 2-sided element to the betting exchange has an effect that is the exact opposite of that claimed by WA: it creates very strong incentives for the exchange to enforce the integrity of its trades. It does so because absent that integrity, punters will need to be compensated through odds that offset the risk of abuse, which obviously will reduce the income available to the platform.

(4) That effect will be accentuated by the fact that if it is true that the WA rules regulating the dealer market effectively enforce integrity, then the risk of dishonest behaviour on the broker market will drive trade to the dealer market, further eroding the viability of the broker market (i.e. the betting exchange).

Excuse these rather long, and not tightly structured, notes, which I hope are nonetheless helpful. Eric may well want to come in on this, not least on the technical definition of a 2-sided market.

Obviously, happy to discuss, elaborate etc as may be required.

All the best,  
Henry

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**Sent:** Friday, 30 November 2007 10:53 AM

**To:** Ergas, Henry

**Subject:** Betfair submissions

Henry,

We understand that [redacted] has spoken with you about Betfair. A brief outline of the matter is that we are acting for Betfair, an online betting exchange, in proceedings in the High Court that challenge the validity of certain WA legislation under s 92 of the Constitution (freedom of interstate trade). The WA legislation:

- prohibits WA customers from betting with a betting exchange; and
- prohibits wagering service providers from publishing 'race fields' (lists of runners in a race) without the approval of the Minister.

Our submissions to the Court are attached.

The proceedings are part heard, and the Court has asked a number of questions of the parties and interveners, including whether the concept of a 'market' is relevant to an analysis under s 92. The Court wants submissions from the parties of no more than 5 pages. WA's submissions (which also set out the questions posed by the High Court) are attached, and it is their answer to question 2 that we would like your assistance with.

In particular, we would like to discuss with you the concept of a "two sided" market, whether it is applicable to the current dispute, and any submissions that Betfair could make (in the limited space it has available) in response.

Please let us know once you have had a chance to consider this material and we can arrange a time to discuss.

Kind regards,