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Public Gaming: *The European Court of Justice recently ruled in favor of the right of*

Portugal to determine its own regulatory and tax policy. The ruling was against the internet gaming company Bwin, which is based in Gibraltar and contended that their Gibraltar license entitles them to operate in all EU member states.

Hansjörg Höltkemeier: This was a very good decision for the gaming industry in Europe. It brings us much closer to having a stable and manageable industry, one in which laws are enforceable. The problem has been that the EU Commission was approaching gaming and gambling just as it has approached all questions relating to trade and commerce. The primary mission of the European Union is to create a dynamic and prosperous economy for all the member states. They have tried to do this by eliminating barriers to free cross-border trade and commerce, and eliminating barriers to free market capitalism and open competition.

The problem is that gambling is an industry that simply must be regulated at the national level. There are two main concerns that require this industry to be controlled and regulated at the national level.

First is the preservation of 'public order.' To treat gambling as other products would be to allow competition to motivate companies to deliver a better level of service, a better quality product, right? Well, is it a "better" level of service to allow off-shore companies to use high payout-ratios, psychologically optimized game-design, and aggressive marketing tactics to enhance the appeal of gambling? In other products, the simple measure of quality and service is whether the consumer likes it and buys it. If you apply that to gambling, you create a model that the gambler may like so much that problem gambling and other social costs go up. That is not a desirable objective for society. This kind of competitive environment with multiple operators and less regulation also increases the possibility

for fraud, corruption, and criminal activities associated with betting. This is what is referred to as "public order." It is the rights of individual member states to take whatever precautions they want to avoid these undesirable consequences and preserve public order that the ECJ – Portugal – Bwin ruling reinforces.

Second, the determination of tax rates and the collection of those taxes must be performed at the national level. Otherwise you have the ridiculous situation in which all the operators locate in states like Gibraltar where they pay less than 1% tax. Then all the gaming revenues generated all over Europe flow to these small principalities, enriching only the private operators and the governments of those principalities. That's tens of billions of euros in gambling revenues. That is great for the operators and great for the little principalities like Gibraltar because it effectively redistributes those billions of euros in taxes away from the markets that generate the revenues, away from the public welfare causes that those billions have always supported, over to private interests based in Gibraltar, Malta, and the other low-tax states. Over the past decade, for instance, the UK has allowed the market to expand on the basis that the commercial gaming operators pay tax on the revenues. The revenues are getting to be quite large, and the markets more competitive, so now those firms that were willing to pay taxes in the beginning are now moving to places like Gibraltar to avoid having to pay the tax.

One of Bwin's and others' primary objections is that they are legally licensed to operate in Gibraltar. As Gibraltar is an EU state, they argue, that they meet the regulatory standards of Gibraltar, and therefore should be allowed to operate in all EU member states. The ECJ ruling states clearly that the regulatory standards and the enforcement of those standards are the concern of each individual nation-state and that a license to operate in one state does not entitle the operator to do business in all states.

H. Höltkemeier: Exactly. In our last conversation, we talked about how there were signs that the EU Commission was beginning to recognize this and the now the ECJ is carrying on to recognize the validity of our position on this issue. The European parliament affirmed a few months ago that the member states were almost unanimous in their support of allowing this industry to be controlled at the state level, and not the EU level. It's called the 'subsidiarity' principle. Now the ECJ has ruled again, that as a matter of law the states should have the authority to determine the kinds of games they want to allow and how to regulate those games. It very clearly expressed that it is not just and reasonable for one state to be factually regulated by another state, as there is no European standard on this issue. And this would be the case here: The foreign operators are licensed in smaller states like Malta and Gibraltar, which have nearly no indigenous market to be protected from unrestricted offers. That enables them to concentrate on the business side of gaming and gambling. This particular model can't be allowed to set the level or be the master plan for our sensitive industry. Preservation of public order is the vital concern of all member states. The only way that can be assured is for the member states to have the right to control and regulate gambling at the state jurisdictional level.

We talked about the 'controlled opening' being attempted by France and Italy. Basically, the concept is to open the markets up to multiple licensed operators, but control them with very strict standards of performance and a higher tax rate than the private operators would like to have. A couple months ago the EU Commission sent a letter to France requesting that they provide more information to justify the high taxes and certain conditions like requiring that the servers that process the internet transactions be physically located in France. I was surprised because it seems to me

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that the EU Commission would be pleased and impressed by France's efforts to open its markets and wouldn't 'raise the bar' like this.

H. Höltkemeier: The problem is that, from our point of view, there is really no in-between middle ground. Either the member state has the authority to control and regulate gambling within its borders or the EU does with an overall accepted regulative framework. As mentioned before, the Portugal-Bwin decision affirms that there is no such framework and it is the right of the individual member state to control and regulate gambling within its own borders.

You might say that this controlled opening is closer to the principles that the EU Commission is attempting to apply. But what difference does a matter of degree make if you do not have a way of reconciling disputes? The private operators will always have something that they will want to dispute. The bottom line is...who decides, the EU or the member state? The Commission can not decide what is best for each individual jurisdiction. And the Commission is not able to enforce the rules and regulations. So how can the Commission decide the rules and then not enforce them? That does not make sense. The rules, regulations, terms, and conditions to operate gambling must be decided by the same governing authority that is responsible for enforcing those rules.

And let me point out one other thing. In the discussions mentioned above, the private operators show their real face as they accept the more liberal aspects in the new models but refuse the strong regulations and the even moderate tax rates. They do not willingly accept an in-between on their own; they press the states with the threat of offering the services from outside Europe.

Are you saying that while the controlled opening might appear to move in the direction of liberalization, that from an EU Commission point of view the controlled opening is really no better than the more strict German approach?

H. Höltkemeier: The EU Commission would say that the controlled opening is much closer to what they want than our strict German approach. I am just saying that the problem of disputes between the private operators and the member states is not solved by getting "closer." The disputes persist. I would contend that they

will persist until the private operators prevail, get the lowest regulation, and pay less than 2% tax. Is a system of multiple operators competing for the business and paying lower taxes "closer" to the principles that the EU Commission has been pushing for? Of course it is. But look even beyond the question of taxes. As you know, there are ways to design games and advertising that will appeal so much to the players that it creates too much excitement and increases problem gambling. Who decides what is acceptable and what is not acceptable when it comes to game design and advertising? You can be sure that the private operators will be testing the limits. Who will make those decisions about what is acceptable? Is the EU going to arbitrate every complaint about overly promotional advertising or game designs that speed up play or otherwise create an unhealthy degree of excitement? My point is that everyone should recognize that the EU can not be the one to make all those decisions. In fact, I would say that part of the strategy of the private operators is for the EU Commission to be put into that position because they know full well that the EU can't address everything they can come up with. Disputes that are unresolved effectively default to the private operators' benefit. But the member state governments can deal with these issues quite effectively and that is not actually what the private operators want. That's why, as a purely practical matter, it makes no sense to put the EU Commission in charge of managing this industry.

Am I wrong in thinking that one of the reasons German "Länder" (i.e. German states) do not want to expand into internet gaming is that it might open the door for everyone, including illegal internet gaming operators, to enter the market?

H. Höltkemeier: That's originally the idea and the thinking of the Länders. It makes the entire issue a very simple and straightforward picture. As long as there is no technical (and jurisdictional) solution to regulate the offers and to prevent vulnerable players from the risk of these games, Internet gaming is illegal, forbidden, period. We all know that it is the communication channel and the medium of the future and – to be honest, we as the lottery companies are looking for solutions to re-open the Internet. But this has to be in line with the

monopolistic framework, as we described before. Of course, the ECJ – Portuguese decision is a very good one for us and perhaps opens the door to new possibilities.

The Bavarian Court ruling against Bwin. A different Bwin legal case in Germany. If I understand it correctly, Bwin was technically licensed to operate in what used to be called the German Democratic Republic (GDR), what was also referred to as East Germany? And as a result of re-unification, they are claiming the right to operate throughout all of Germany. How will this issue be resolved?

H. Höltkemeier: From my perspective, it is mostly resolved. Bwin and others used the Constitution and laws supporting the re-unification process to build a lucrative business in all parts of Germany. They bought licenses from betting-shops in one German state and then argue that these are also valid in other German states and for internet business. The courts are now making firm decisions that are enforceable. The higher Bavarian court decisions in Munich as well as in Northrhine-Westfalia are very important steps towards enforcing the laws against the illegal operation of betting shops like were operated by Bwin. Bwin was hoping that the ECJ would rule in their favor in Portugal. That did not happen. So their recourse with the European Union Commission is not likely to be helpful to them either. The higher court decision, combined with the ECJ-Portugal ruling, is very helpful to Germany in its efforts to preserve stability and order in the gaming market.

Won't Bwin now try to petition the highest German Constitutional Court, the National court, to overturn the Länder Court, the Bavarian Court?

H. Höltkemeier: I do not know what they will try to do, but I am confident they will not succeed. There are several decisions that indicate a clear ruling in the direction the provinces are already going. I am not naïve to think that companies like Bwin will just leave Germany. They have to fight as this is their mandate from their shareholders, but I believe that gaming is a part of public welfare and that the broad range of stakeholders in this are more relevant than the shareholders of a private company. ♦