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The "Economics" of the State Lottery Internet Business:

The EU Legal Perspective.

"In recent years gambling and games of chance have increased significantly. They now constitute what may be described as a considerable economic factor. In the first place, they generate a very large income for the organisations that operate them. Secondly, they provide a substantial number of jobs in the different Member States. (Opinion of Advocate General Y. Bot in the Liga Portuesa de Futebol case before the European Court of Justice, §27)"

The European Court of Justice (ECJ) has consistently held that the funding of good causes can only be an ancillary benefit of a restrictive policy, but never provide a legally acceptable reason for restricting gambling services in an EU Member State. This statement was also endorsed by the EFTA Court for Norway. The situation became even worse when the ECJ decided in Gambelli that a Member State policy can only be restrictive if it aims at a genuine restriction of gambling opportunities. This statement was largely used by some private operators to undermine the various state regimes by pointing towards the "economic" approach of lotteries through intensive advertising and other forms of marketing in order to increase turnover and profit for the State.

The judgment of the ECJ in Placanica brought relief when the Court ruled that a policy of controlled expansion was acceptable when restrictions where imposed upon gambling services to protect the consumer against crime and fraud. The EFTA Court considered that such policy of controlled expansion was equally acceptable when the objective pursued by the concerned government was to protect the consumer against the risks of excessive gambling and addiction. This EFTA Court ruling is today questioned in several ECJ cases by the Advocate General of the ECJ.

In recent opinions in Liga Portuguesa de Futebol and Sjöberg, the Advocate General of the ECJ went deeper into the "economic" question. According to Advocate General Y. Bot it falls to each Member State to assess, having regard to its own situation and its social and cultural characteristics, the balance to find between, on the one hand, an attractive range of games in order to satisfy the desire to gamble and to channel it into a lawful system and, on the other, a range which encourages too much gambling.

He added that the power of the States should only be limited by primary EU law (meaning the EU Treatry) to the extent of prohibiting conduct whereby a Member State deflects restrictive measures from their purpose and seeks the maximum profit. In other words, a Member State should be constrained to open to the market the activity of games of chance and gambling only if that State treats it, in fact and in law, as a true economic activity from which the maximum profits should be derived.

The case addresses the issue of Internet gambling and the right of States to prohibit cross border supply even by an operator legally licensed in another jurisdiction. The Court did indeed accept in Liga Portuguesa de Futebol that a Member State was "entitled to take the view that the mere fact that an operator such as Bwin lawfully offers services in that sector via the internet in another Member State, in which it is established and where it is in principle already subject to statutory conditions and controls on the part of the competent authorities in that State, cannot be regarded as amounting to a sufficient assurance that national consumers will be protected against the risks of fraud and crime, in the light of the difficulties liable to be encountered in such a context by the authorities of the Member State of establishment in assessing the professional qualities and integrity of operators". In terms of European law, this means that the so-called principle of mutual recognition does not apply. According to this principle Member states need to take into consideration the licenses granted in other Member States. In gambling the Court has denied that this principle is applicable.

In line with the WTO Appellate Body ruling in US cross border supply of Internet gambling services- complaint by Antigua, the European Court took the view that "because of the lack of direct contact between consumer and operator, games of chance accessible via the internet involve different and more substantial risks of fraud by operators against consumers compared with the traditional markets for such games."

The Court did therefore accept that a total ban on cross border supply of Internet gambling services, combined with a monopoly operated by an entity under strict state control was an appropriate way to confine gambling within controlled channels. Such approach is, according to the Court, appropriate for the purpose of protecting consumers against fraud on the part of operators.

In Sjöberg, the Advocate General seems to go even one step further by stating that in such circumstances it is not relevant whether the entity concerned operates a normal economic activity and tries to maximise profits.

Indeed in his opinion in Sjöberg dated 23 March 2010, Advocate General Y. Bot argued that "if a national measure seems appropriate to protect the consumers against the risks of crime of fraud entailed by games provided via the internet, as is the case with a monopoly granted to a state controlled entity – a restriction which can even result in a total prohibition for foreign operators to accede the market, regardless of the legal frame in their country of establishment – it can be compatible with EU law". He adds that it is not important for the compatibility assessment whether the entity involved exercises its activities as a normal economic service in the light of maximising profits and whether the measure achieves its other pursued objectives (such as the protection of the consumer against gambling addiction).

Whether the Court will follow this reasoning, is not certain, but if that

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GLI has long been recognized for its expertise in testing and regulatory matters. What we've now added is a super high level of data-driven analysis and process engineering to enhance the impact and value that ultimately reaches the customer.

I would think that governments and regulators would want to streamline the licensing process and look for ways to rationalize the regulatory frameworks. Wouldn't there be a set of regulatory requirements that are shared by at least more than one jurisdiction? Couldn't jurisdictions get together and create a common set of regulations that enables a licensee to operate in all the different jurisdictions? Is there any aspect in which GLI can leverage its incredible database of regulatory spec's and conditions to help regulators streamline and expedite the licensing process?

P. Barow: There's actually two sides to this question. First, there is the technical side. GLI has always been very strong on this side of the business. We actually help manufacturers leverage the regulated technology they've developed in one market and bring it to another market. Regulators recognize the value, quality, and credibility of a GLI certified mark. They understand that it's been thoroughly vetted, the technology works reliably, the players are protected, the game operates to spec', etc. So in some ways we do help with the harmonization of technology.

But the other side to this question is more subtle. From a public policy point of view, regulatory frameworks may appear to share some commonalities. But from a purely technical point of view, there are going to be far fewer commonalities than you might think. The Italian regulatory environment is going to be much different than the French regulatory environment from a compliance perspective. So companies will have to overcome many different hurdles in terms of anti-money laundering regulations, reporting, responsible gaming, compliance in terms of background checks, and whole host of other issues in one country than they would in another. Terms, conditions, technical specifications are all set nationally and so all differ from one jurisdiction to another and that basic system will not likely change. Each government has a rich history of hundreds of years of operating with a focus on the individual needs of its citizens. They each have their own culture, their own political systems and moral sensibilities and customs. I think you'll find that the enlightened operators and manufacturers respect that fact. GLI has been able to help them harmonize on the technology side. There are very similar technologies all across Europe as in North America and there are ways to harmonize the technological platforms and gain some efficiencies in the process of making the product be compliant with multiple jurisdictions and different specifications and requirements. Manufacturers all want to expand abroad and need to have efficient, cost-effective ways to become compliant and get licensed in different jurisdictions. GLI is positioned well to facilitate this process.

What about harmonization on the regulator side – do you envision the regulators getting together and creating a certain minimum standard that could serve as a foundation upon which they would each then build their own additional requirements?

P. Barow: I don't, really. As I mentioned, there are just too many characteristics unique to each system to make that possible. Granted, the technologies and even regulatory issues may not be 100% unique to each jurisdiction. But when you add in the variety of cultural, political, and legal aspects that go into the formulation of a regulatory framework, you really end up with very little that is actually common to all jurisdictions. There are lots of things that regulators do to rationalize the process. They just can't do the short-cut that you are suggesting. Regulators can and do learn from each other's experience and GLI does what it can to facilitate the process of communication and sharing to help regulators build the most effective framework. For example, we are the only company of our kind to hold regulators roundtables to help bring about these types of conversations. And we hold them in North America, South America and in Europe. It happens all the time that regulators describe a new issue and our input is almost always to refer to how others are dealing with a similar issue and help them assess what works best based on how things have worked in other markets.

Two technical issues that seem to be at the heart of disputes between remote internet gaming operators and governments: IP Blocking and the requirement to locate the transaction-processing server in the place of consumption, i.e. where the players are located as opposed to where the operator is based. Is IP blocking technically difficult?

P. Barow: Those are questions that a lot of people are wondering about, including me! First, there is a large component of public policy to these issues which is not our place to comment on. For instance, technologically there may not be much of a difference to where the server is physically located. Most of the reporting and auditing functions can be conducted effectively no matter where the server is located. But there are other considerations to having physical access to the server and it is likely that some jurisdictions will deem them to be perfectly legitimate concerns. Same thing with IP blocking. Sure, the technology is there to effectively block your citizens from accessing banned websites. But there are a number of public policy issues that need to be addressed, and that is done by the individual jurisdiction based on a broad range of factors, more to do with public policy than with technological capability. It comes down to the will of the people and the government of each jurisdiction. ◆

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would be the case, it provides the States with an important potential to increase the return from gambling services as long as the main objective is to prevent the risk of fraud and crime.

The Betfair and Engelmann cases need to be put into this context. In both cases the question at stake is how the States can grant a licence to operate games of chance in a restrictive environment to a private operator. In both cases respectively Advocate General Y. Bot and Advocate General J. Mazak consider that the allocation of licenses must be done through a non-discriminatory and transparent procedure accessible to all EU based operators.

To the extent that the European Court would follow Advocate General Y. Bot in his opinion in Sjöberg and if States would decide to replace a total prohibition of Internet gambling by proper regulation to prevent the risk of fraud and crime connected to Internet gambling and as such confine the operations within controlled channels, this could be done under economic terms.

To do so, one needs to realise that transnational cooperation, initially at EU level, is required to keep control over an essential transnational market. Combining a strict residence requirement and rules for an adequate national control mechanisms such as the obligation to operate some local servers with the potential of a coordinated approach with licensed operators operating in other jurisdictions, based upon the model of certain multi-jurisdictional lottery games, could create an economically valuable solution allowing to continue the expansion of gambling operations within a controlled and safe environment.

It could turn out to be a lucrative market…also for the State and provide a path for a transatlantic approach. ◆