

PGRI Introduction: The advent of internet gaming introduced a whole new magnitude of regulatory issues. After almost twenty years, the lotteries and member states of the European Union are beginning to see the light at the end of the tunnel. The EU Commissioner for Internal Markets, Michel Barnier, recognized the need to update and rationalize the requirements placed on EU member states to comply with European law. The European Parliament has stated clearly its position that matters of regulation and taxation should be determined at the member state level as opposed to the EU level. The EU Commission and the Courts have come around to recognize that member states' rights to self-determination can co-exist with EU principles and are acting to clarify the rules accordingly. Now comes the Next Big Thing that will require a new layer of regulatory action: Social Gaming. It will not be long before games of wagering and chance that are applied to social games will become available to the public. The need to effectively regulate and tax this new gaming category will be both problematic and imperative. Philippe Vlaemminck has been at the center of all of these issues for twenty years. With a perspective informed by representing the Government of Belgium in most of the cases decided at the European Court of Justice in Luxembourg, as well as several individual Lottery operators in the EU and the European Lottery Association in the EU regulatory debate, Philippe has always worked hard to engage all of us, all the stakeholders of government gaming, in the effort to defend the regulatory model that supports the cause of government lotteries. Talking with Philippe at the "Industry Days" conference in Amsterdam about the ways in which regulatory frameworks will evolve to address the new category of social gaming turned into this interview that clarifies the foundational principles of EU laws.

Paul Jason, Public Gaming: *We know that EU member states have the right to control gambling for the purpose of protecting the consumer, preserving "Public Order." But as a legal matter, is the EU Commission still conflicted over the issue of whether a member state has the right to control gambling and lottery for the explicit purpose of channelling economic benefits to good causes that benefit the public.*

Philippe Vlaemminck: The precise application of the law can come down to the specific wording that is used. That is especially true as it relates to the issues of gambling regulation in Europe. The whole concept of the European Union is to support a free market system that ensures cross-border trade, open competition, and freedom of establishment. It was in 1992 that the European Court first addressed the question: to what extent should lotteries be allowed to be operated in an environment that restricts free trade and commerce? The Court decided that it is alright to use a government lottery for the purpose of preventing private profit from gambling. The government is allowed to have the monopoly

model for its own lottery and channel the profits back to government and good causes for the purpose of preventing excessive gambling and illegality in the market-place. That rationale is not inconsistent with EU laws that require free and open competition in the market-place because, in effect, the public policy objective is not to produce a profit or serve an economic interest group, but to prevent criminal enterprises from profiting in an underground market. If, however, the sole and actual purpose of preventing multiple operators from competing with the government lottery is only to enable the government to maximize the profits to good causes, that is not legal under EU rules. The European Court of Justice decided that using the lottery for the sole purpose to maximize economic benefits to good causes is inconsistent with EU laws that require all member states to allow free and open competition. That is why, from a legal point of view, the non-economic value of lottery prevails, like its role of preventing illegal operators from profiting from lotteries, or like protecting the consumer and preserving Public Order. In our European



Philippe Vlaemminck

Partner, ALTIUS

Philippe.Vlaemminck@altius.com
www.Altius.com

legal terminology, it is illegal for lotteries to focus on the objective of maximizing economic value to good causes. However, if in the course of producing non-economic value like preserving Public Order and preventing illegal profiteering in the market-place, an ancillary result is that funds are produced that end up going to good causes, then that is not illegal. Equally it is acceptable to decide that no private profit can be made from gambling. These legal distinctions may seem semantical, but they are quite material to the whole issue of regulation and taxation in the European lottery and gambling markets.

Advocates for the license and regulate model contend that commercial companies are just as capable as government operators at implementing whatever standards of responsible gaming are required, and for complying with any and all other standards of performance for that matter.

P. Vlaemminck: The thing is, those standards of performance need to be quantifiable, and indices of performance measurable. The public policy mission of channel-

ing economic activity away from criminal enterprises and towards regulated and taxed enterprises requires an approach to business that does not readily lend itself to easily measurable objectives. Let's say the goal is to allow the promotion of games for the purpose of getting existing players who are playing on illegal websites to play on the legal and government-authorized websites. How do you draw the line between that and promotions that have the affect of over-stimulating the market, enticing consumers to play more in a fashion that is not consistent with the intended public policy? Either way, the operator is promoting the appeal of the games and making their products available to the consumer. If the fundamental purpose of a corporate enterprise is to increase sales, profits, and shareholder value, then the ability to find the nuanced distinction between those two different advertising agendas is difficult and requires a permanent search for a dynamic equilibrium between a controlled expansion and the need to aim at a genuine diminution of gambling opportunities as the European Court says. It may also be difficult for a government operator, but at least the mission and purpose of the organization is not conflicted. It can focus clearly on a mission that focuses on qualitative and non-economic value that is harder to measure, like genuine responsible gaming and corporate social responsibility values, just as much as it focuses on easily measured indices of performance that tend to be economic, like sales and profits.

The point is not that commercial enterprises should not be licensed to operate wagering games. The point is that the EU is based on the principle that if the sole and actual purpose of the enterprise is to maximize economic value, then the concerned government is not allowed to erect obstacles to protect the interests of any single enterprise, even if it is a lottery that is producing funds that benefit the public. As a matter of legality, lotteries need to serve purposes other than that to justify their monopoly model. And we need to demonstrate exactly how and why those other purposes, like protecting the consumer and combating illegal operators, are better served by the monopoly model than by a free-market driven model. We need to show how and why the goal of generating those non-economic values in the lottery industry is best served by application of the traditional monopoly construct. The alternative of licensing multiple operators would be a mission conflicted over the need to serve shareholders and the need to accomplish

public policy objectives that are in fact at odds with the objective of maximizing profits for shareholders.

As a general rule, a pure market-driven approach has effectively united the goals of increasing shareholder value with the goals of improving quality and service that benefits consumers. This coalescence of interests creates the never-ending cycle that reduces prices, increases consumption, and by most measures, increases wealth and standards of living. That's good for almost all categories of goods and services. It's not, as the European Court's Advocate General said already in 1992, the right model, though, for gambling and lottery.

The position of the EL Association and ourselves is that regulatory decisions should all be made at the Member States (or sub-regional) level whenever possible, and especially as they relate to the protection of Public Order.

What is the current status of the efforts of Michel Barnier and the EU Commission for Internal Markets to rationalize the regulatory framework in Europe? Will they allow the member state to control the regulation and taxation of gaming and gambling?

P. Vlaeminck: In the most recent speech which he delivered to the European Parliament on the 27th of June, Michel Barnier said that the action plan of the European Commission in relation to online gambling will focus on a number of issues as consumer protection, protection of minors and vulnerable persons, the fight against crime and money laundering, law enforcement and cooperation as the protection of the integrity of sport. Finally, Commissioner Barnier insisted upon the need for the Member States to develop a consistent policy. Various points mentioned are already adequately approached by the EU Member States and do actually, in my personal opinion, not require further intervention of the EU. The Member States need to keep the essential competence. The EU does only need to help where the Member States can not properly resolve the problems by themselves.

Consistency is indeed one of the key elements in Barnier's approach. It is permissible to allocate profits to good causes, as long as you actually do that in the context of trying not to maximize gambling activities, nor to (over)stimulate demand and consumption. Mr. Barnier indicated that the EU should be involved in establishing standards that pertain to consumer and player protection, responsible gaming and protecting against ad-

diction, prevention of minors from playing, and serving other goals that minimize social costs and maximize consumer protection. I do personally think that we need to be very careful with this. The focus of the EU should be not over-controlling the taxation and regulatory model that the individual member state wants to apply.

Second, he wants to give special attention to the issue of fraud and money-laundering. He astutely recognizes that there are some matters that are in fact better addressed in an international framework and is leaning towards focusing on those matters and allowing the member states the latitude to deal with matters that do not require an international approach. Fraud and money-laundering, for instance, cannot be attacked on a national basis. They require an international cooperation. If criminality is abided in even one member state, it is very difficult for the others to prevent it from insinuating itself into their jurisdictions as well. These are some of the global issues that Mr. Barnier thinks should be the object of attention for the EU Commission for Internal Markets. We need to have an international agreement that will enable the enforcement of laws against criminality of any kind.

As regards to the regulation and taxation policies of the individual member states, he will require consistency. Laws within a member state must be consistently applied to all economic interests. Good Causes cannot be favored over other economic interests, and more dangerous forms of gambling (like slot machines) cannot be regulated in a less restrictive manner than less dangerous games (like lotteries). But unlike his predecessor, Mr. Barnier recognizes that consumer protection and preventing illegality are important and legitimate public policy objectives, and that the lottery model has served that purpose, and as long as governments stay very clear on the need to stay consistent with all EU laws, member states will be able to control their own regulatory and taxation frameworks. In September we are expecting to see more on this when the so-called action plan will be published.

It sounds like Mr Barnier has a thoughtful and enlightened view. The importance of his role and influence cannot be overstated, so we are fortunate that the future of gaming regulation in the EU appears to be in good hands.

P. Vlaeminck: Correct. He is a much more realistic politician than his predecessor, distinguishing the matters that are best

decided at the EU level from those that can and should be controlled at the member state level. It appears that he appreciates the clear political statements made by both the Council of Ministers in December 2010 and the European Parliament including on the specific role of Lotteries for society that as long as government lotteries have as their primary mission the fulfillment of non-economic objectives, they will be allowed to work within the monopoly model and the funds generated can be channeled to good causes. But of course, he is dealing with a broad spectrum of issues and not just that alone.

What exactly do you mean by “consistency”?

P. Vlaemminck: If the goal is to protect the consumer and prevent illegality, then over-promoting the games for the purpose of increasing revenues would be inconsistent with that goal and therefore illegal. The same applies to regulating various games in different manners whereby more dangerous games would be more easily available and less regulated than the least dangerous games. But for us, there is more. There is the Lottery model of operating games in a consumer friendly manner towards a large group of players, avoiding excessive gambling, but responding to the modern needs of society, combating illegal gambling and serving society, that we defend as the most consistent model. The best way to defend consumers is to defend public order and enhance law enforcement.

The French model, the concept of “controlled expansion” would seem to be precisely geared towards that goal.

P. Vlaemminck: Yes. As a market matures, consumer tastes evolve and new games become popular. As a matter of public policy, then, the government may decide that the underground activity is reaching a level where it is preferable to regulate it properly. The expansion of government into new games and channels is driven not by a desire to increase funds for good cause, but by a desire to protect the consumer and prevent criminal enterprises from profiting. Of course, the addition of new games and channels of distribution needs to be advertised to make their availability even known to the consumer. And all of that is legal according to EU laws. It's just that if the level of aggressiveness to expand appears to be more for the purpose of stimulating demand and increasing revenues than for the purpose of protecting the consumer and fighting illegal operators, then that is inconsistent and not compliant with EU laws.

I think we can all get the meaning and intention of the idea. But won't everyone have a different notion as to how to apply it? Is the EU Commission going to be in the business of analyzing television advertising to see if it is too “aggressive”?

P. Vlaemminck: Fortunately, in general it is not that hard to draw the line and identify advertising that is too aggressive. But to your point, there will certainly be opportunities for rational, reasonable people to work out mutually agreeable resolutions.

How will these concepts apply to social gaming?

P. Vlaemminck: That will be an increasingly important question. Notice that Zynga states on its website that their players give \$10 million a year to good causes. Now, \$10 million when you have 250 million players is really nothing, and is especially nothing compared to what lottery does. But it is interesting because it indicates that these commercial operators realize that they need to have a public service orientation, or at least appear to have one.

Social games will pose some perplexing public policy issues. On the one hand, they seem to be non-threatening now; partly because they are free, but also because they seem to be more about entertainment than wagering. But think about it. Social games can be extremely engaging, holding the attention of players for long periods of time. I recently saw an advertisement saying, “We created the most addictive game in the world.” That was in the context of a free non-wagering social game so the fact of being “addictive” does not have the negative connotation it does in the gambling world. But what happens when the layer of wagering is added to social gaming? I'm sure they will drop the reference to being the most addictive game in the world! But how much more difficult will it be for the operator to refrain from making games that are incredibly appealing, to the point of being addictive? In fact, think about it even within the context of controlled expansion. When wagering is applied to social gaming, shouldn't we expect the consumer to gravitate towards the most fun and exciting, even “addictive” games? This could pose some real challenges. That is why it is so important to have some of these basic principles in place now. They won't necessarily cover all the contingencies, but at least we will be in a position to work through it in real-time and not have the market run away from us and gain too much momentum before the regu-

lations catch up. If Zynga-type social games were to be integrated into an online casino format, the potential for increased problem gambling could be very high.

Regulatory frameworks have always lagged behind technology and consumer trends. And it creates a huge breeding ground for illegal operators to get established before the governments have time to catch up. Won't this be even more of a problem when it comes to social gaming?

P. Vlaemminck: That is all well-understood in Europe even now. It doesn't mean the problems will all be solved, but at least the people in the position to shape public policy understand the importance of having a regulatory policy and means of enforcement that address the needs of the industry. The fact that internet gaming must be regulated is an accepted fact in Europe. So we will now include social gaming as the newest wrinkle that needs to be addressed. I worry that the U.S. is not responding to the need to evolve regulatory frameworks to be relevant to the actual state of the industry. Jurisdictions that do not have a framework for regulating and taxing the i-gaming industry will be ill-equipped to deal with the addition of the next layer of internet gaming, which is social. The complexity of it will be significantly greater, as will the potential for problem gaming and fraud.

To what extent will the adoption of social games follow the path that internet gaming has taken?

P. Vlaemminck: There are many similarities between what is happening now and what happened ten years ago in the internet gambling community – except that the companies involved now are well-funded and very sophisticated corporate enterprises like Facebook and Google on the distribution side and Zynga, Electronic Arts, and an explosion of other software companies on the game content side. Listen to what they are saying. First, Facebook et. al. are saying that they are global companies and therefore it is not practical to expect them to comply with the rules of individual countries. It is frightening because Facebook, with over a billion subscribers now, is bigger than the combined populations of United States, Canada, and all of Western Europe. Next, as a matter of legal strategy and political posturing, they will defend the rights of the consumer to decide for themselves how they want to spend their money and their time. And of course they are staunch defenders of free speech, so regulations will be represented as censorship. It is

not too soon to get out in front on these issues and do what we can to inform the shapers of public policy of the need to address the need for regulation of social gaming.

Stanleybet is an operator that does not want to comply with the rules in Italy. Or pay taxes. Same thing with Bwin which is refusing to comply with Belgian laws and regulatory policies. I don't understand how that works. I mean, how can these operators state outright that they have no intention of complying with the law and refuse to pay taxes?

P. Vlaemminck: The situations of Bwin and Stanleybet are not completely the same. Bwin is the driving force of the European Gambling and Betting Association, and is advocating for a kind of free European market, a pan-European regulatory structure that allows them to operate everywhere. Actually, they want the same thing for the entire world: a licensing model which is the best for commercial operators which means lowest taxation and less regulation. Belgium is of course a small country, but has a very consistent and well-reasoned regulatory structure that is compliant with EU rules and principles. Bwin complies with the rules of France, Italy, and Spain. In Spain, they even pay back taxes for revenues accrued before they were legal and taxed. Bwin is doing all that because Spain is a very big market and there is no alternative if they want to be legally licensed in Spain now. At the same time, Bwin uses Belgium as a country to challenge because it's not their biggest market, and they feel that a win against Belgium will set a favorable precedent that can be applied in other jurisdictions. Belgium is also the country in the lead in all cases at the European Court of Justice. That is why Bwin refuses to comply with Belgian laws. The Belgium Gaming Commission is enforcing its policy of black listing whereby the ISPs (internet service providers) are blocking illegal operators like Bwin. The Bwin lawsuit against Belgium is important because it will further clarify what is permissible under EU rules.

Is it effective?

P. Vlaemminck: It works quite well. Residents of Belgium can't access Bwin's websites. When you try to connect to the Bwin site, a page with a big "Stop" on it appears and the viewer is invited to click on a link that goes to the Belgium Gaming Commission where there is information about why the website is being blocked.

And Stanleybet?

P. Vlaemminck: Stanleybet is officially a UK company that was bought by Italians and so is now owned by Italians. Stanleybet's approach is to contend that the Italian legislation does not comply with EU laws. They have been very clever in the way they've done it in order not to be obliged to comply with the Italian legislation. They are attempting to create the impression that they are victims of discrimination. The reality is that Stanleybet operated initially without respecting the licensing rules. But they succeeded at hiding their illegal activities and just claimed that they are being unfairly excluded from the market. Creating confusion over the facts is a typical strategy used by remote operators which do not want to comply with the laws and pay taxes. I think we can expect much of the same from the operators of social games.

So, Stanleybet is playing a game in which they don't really even want to address long term issues, they just want the legal system to drag out so that they can lengthen their short-term operating profits - and in the process maybe find loopholes that will enable them to be licensed in Italy?

P. Vlaemminck: Basically, yes. And Bwin is the opposite. They are a dominant operator in Europe and they don't really care about their short-term profits in Belgium because they aren't making any here. They're using the case in Belgium to try to establish a principle that can be applied to the markets where they do make money.

I read that Spain and Italy might forge a cooperative relationship on i-poker and maybe i-gaming. Is it realistic to hope that countries like Spain, Italy, France, Belgium, and others could come together and require that a condition of being licensed in one individual country is that you not be in violation of laws in any of the other countries that are a part of this kind of mutual agreement?

P. Vlaemminck: That is a principle that we and the EL Association are advocating for. The logic is that you cannot be a criminal and a good citizen at the same time. And each individual country should respect the rights of its neighbors by refusing safe harbour to criminals. I think it is already a reality to a certain extent. For example, the Belgium blacklist identifies companies like Bwin which are trying to enter the Belgium market in an illegal manner. The gaming boards of other jurisdictions are taking this fact into

consideration. So these remote operators do need to consider the collateral damage of acting illegally anywhere. We are definitely pushing for that principle to become widely adopted. It's a simple concept. The operator must maintain legal status everywhere if they are to be sanctioned anywhere.

Is it likely that important jurisdictions like Spain, Italy, the U.K., and France can agree on a sweeping agreement like that?

P. Vlaemminck: Cooperation between member states on gambling is only just starting to happen. It will take some time before you can actually define and agree to the exact terms of that cooperation. There are costs to it and many legal matters of international legislation that make it complicated. But the need for it is apparent, there is no reason it can't be done, and that's why I strongly believe that it will happen.

Is there a threshold beyond which the value proposition of the legal operator becomes so inferior to the illegals that the consumer is driven to accept the higher risk of playing on illegal sites? This is the argument of licensed operators in France and other markets to lobby for lower taxes.

P. Vlaemminck: Taxation is just one element of a regulatory framework and should not be viewed in isolation. You need to look at every aspect the industry and the marketplace. The kinds of games, the existing underground market, the enforcement mechanisms all interact with the public policy considerations about the kind of gambling market is best for a specific jurisdiction. Some states have a very high level of corporate taxation. Taxation and all other regulatory requirements are technologically enforceable. In Spain, operators actually were compelled to pay back taxes in order to receive a license. That is indicative of the enforceability of tax and regulatory laws and the fact that these operators would not have been able to do as well operating illegally. These operators do not like to pay taxes, so if they could have made more money operating underground, that's what they would have done. The level of taxation is a matter that is determined by each jurisdiction and should be considered in conjunction with a comprehensive regulatory framework.

But isn't the Denmark model based on the assumption that taxes must be low in order to attract the consumer away from the illegal operators?

P. Vlaemminck: I should acknowledge

that I am on record as being in disagreement with the Danish model. It is an example of not looking carefully at the whole picture to come up with a comprehensive plan that addresses all gaming categories and channels in a logical way. Their system is out of balance because they have high taxes on land-based gambling and low taxes on internet gambling. So the system is being challenged in court for discriminating against land-based operators.

It is not for me to say how low or high a tax rate should be. But we should recognize that the tools to prevent the consumer from accessing illegal websites are in place and proven to be effective. Licensed operators who pay taxes are not at a disadvantage over illegal operators who do not pay taxes because the consumer is not able to play on the illegal sites. And the tax structure should be viewed as a part of the big picture. Attempts to use low tax rates to help one interest group can have many undesirable consequences. Treating all categories equally is not just a matter of fairness. It is also a matter of maintaining stability in the market-place and ensuring a long-term sustainable industry. Promoting Internet gambling, which is considered to be a more dangerous form of gambling, by taxing those

activities less than land-based gambling seems to me an inconsistent policy.

What are some of the legal issues that European lottery operators will be facing in the next year?

P. Vlaemminck: Many of the questions that relate to the big issue of member states' rights to regulate the industry have been addressed. There is still need for further clarification, but we are well on the way to getting that. There remain countless detail issues that will always be coming up.

Many of the laws and principles that have been established to apply to internet gaming will be very useful precedent for the regulation of social gaming. But the convergence of channels, media, and games will introduce new issues. The restructuring of management structures such that government operators are now offering commercial services and commercial partners are moving into the operator space as private managers will further complicate the business of regulating and taxing the industry. The most important thing is for all of us who have a stake in the long-term sustainability of this industry push hard for legislation that is logical and serves the interests of the public. ♦

Philippe Vlaemminck is widely regarded as a leading player in the current debate on gaming and gambling in the EU, and has been involved in every gambling case before the CJEU and the EFTA court. He joined the ALTIUS partnership on 1st July 2011, where he heads the EU Regulatory and Trade Practice. (e-mail: philippe.vlaemminck@altius.com)

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