

UK ONLINE GAMBLING – WHERE DID THINGS GO WRONG?

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The Gambling Act 2005 (the **Act**) came into force in 2007 and was hailed as a model for the rest of the world in terms of liberalising the UK gambling market in a socially responsible manner and in accordance with EU law.

The Act created the Gambling Commission, which is responsible for all commercial gambling in the UK, including remote gambling. It has three statutory objectives: to keep gambling free from crime; to ensure that gambling is conducted in a fair and open way; and to protect children and other vulnerable people.

However, two years after coming into force, the Act has failed to attract online operators to apply for a UK gambling licence. Additionally, the UK's ambition to lead and be an example for the liberalisation of the European online gambling market has not been realised.

The UK Government is therefore reviewing the UK's position so as "to create a level playing field" for UK gambling operators. Hopefully, its review of where things may have gone wrong will also include recommendations about what should be put right.

But where did things go wrong? Why has the liberal and well regulated UK gambling market failed to attract the success it deserves?

The simple answer is that the cost to UK gambling operators is too high. However the informed answer is more complicated and requires an analysis of the impact of UK, EU and offshore developments on the future of UK online gambling.

UK

Under the Act, all online gambling operators operating from the UK (i.e. those who have 'remote gambling equipment' in the UK) have to be licensed by the Gambling Commission. This is expensive. There is also a remote gaming and betting duty of 15% of profits and corporate tax rates of up to 30%. Additionally, there is a requirement to contribute to the Horserace Betting Levy and the treatment of problem gambling. The demands of sports bodies for a "fair return" through previously unheard of 'Sports Rights' may result in a further burden.

Are these high tax rates and additional costs the only explanation for the UK's problems? Not necessarily: a more decisive factor is the combination of these matters with the UK Government's open market approach. As will be seen, this may be significantly damaging to UK online gambling. There are two elements that are important to consider:

- **Opening the market to white listed jurisdictions:** The UK Government allows advertising by operators licensed in the UK and in white listed jurisdictions, where

regulatory standards are considered to meet UK standards. Operators in white listed jurisdictions do not require a UK gambling licence and are not subject to UK tax or other financial contributions. Currently these jurisdictions include Alderney, Isle of Man, Antigua & Barbuda and Tasmania. Most of the white listed jurisdictions are also considered to be tax havens that (self evidently) the UK cannot match, and so UK based gambling operators will find it hard to compete on this basis.

- **Opening up the market to the European Economic Area (EEA):** The UK considered restricting advertising only to white listed jurisdictions. However, there were thought to be serious EC law implications arising out of Article 49 of the EC Treaty relating to the freedom to provide services between member states, and the Act permitted gambling operators located in the EEA (**EEA operators**) to advertise to the UK. There is no requirement for EEA operators to apply for a UK gambling licence, nor is there any requirement to pay UK tax or make other financial contributions. Further, while the UK grants free market access to EEA operators, most EU member states continue to restrict and prohibit UK licensed operators from accessing their markets. For example, UK gambling operators are prohibited from accessing the Austrian market, while Austrian gambling monopolies are at liberty to exploit the UK gambling market without paying UK taxes. Additionally, unlike white listed jurisdictions (which are assessed on their regulatory standards), EEA operators are not assessed at all: they can just “come in”. EEA operators are only required to meet UK advertising standards, but there are no requirements, for example, relating to the level of player protection in place in the relevant “home” EEA state. This in itself potentially undermines the Gambling Commission’s ability to pursue its own objectives stated above, because the Gambling Commission has no jurisdiction over EEA operators.

It is therefore no surprise that UK based online gambling operators find it hard to compete with operators based in white listed jurisdictions or elsewhere in the EEA.

The UK Government is therefore responding in two ways. First, the Department of Culture, Media and Sports (**DCMS**) has frozen applications to its “White List”. Secondly, the Gambling Commission and the DCMS are reviewing the current system and will consider issues such as “securing fair contributions from overseas licensed operators towards the costs of regulation, the treatment of problem gambling and the Horserace Betting Levy”.

Given the current situation, any such review is clearly important for the future of the UK online gambling industry. The effectiveness of any recommendations resulting from this review will, however, be greater if it is acknowledged that, currently, there is one set of rules for operators located in the UK, a different set of rules for white listed jurisdictions, and another set of rules for the EEA – all of which need to be understood. Only then can the UK play its cards in a way that ensures that there is “fair play” for all, not only for some.

EUROPEAN GAME RULES

Online gambling has presented a new challenge to the EU, which is trying to balance the freedom to provide services across EU member states (Article 49) with the demands of EU member states to protect their gambling markets and monopolies.

There is no EU Directive on gambling services. Various member states therefore continue to control their domestic gambling markets by restricting internal and external competition, even though this violates Article 49. There is also no apparent political will to

regulate online gambling at a European level. There have, however, been indications as to where Europe may be heading through (1) case law, (2) EU Directives and (3) the European Commission's stance on the "controlled" opening of former national monopolies.

Case Law: The UK has complied with Article 49 by opening its gambling market to EEA operators. It appears, however, that the UK's (we believe correct) interpretation of Article 49 is not shared by other EU member states, which have different approaches to the principle of the free provision of (gambling) services. Those different approaches derive from two public interest sources: (1) from the interpretation of Article 46(1) of the EC Treaty, which permits derogations from Article 49 by allowing restrictions that are justified on grounds of public policy, public security or public health, and (2) from case law that has approved derogations from Article 49 on the ground of overriding public interest, such as consumer protection, the prevention of fraud and of any incitement to squander money on gambling, and the need to preserve public order.

"Public interest" defences are, however, wide and can be abused. It is therefore necessary to refer to European Court of Justice (**ECJ**) decisions to assess to what extent Article 49 can be circumvented by EU member states in the context of online gambling. According to the ECJ:

- national legislation must be genuinely directed at limiting the harmful effects that are given as reasons to justify restrictions on cross-border services¹,
- restricting gambling activities to state-licensed undertakings is unlawful if the restriction is based on purely financial grounds. Restrictions can only be justified on public policy grounds and where the protection of the public is their main purpose²,
- restrictions on the number of operators must reflect a "genuine diminution of gambling opportunities", however the limitation must be consistent and systematic. Channelling gambling into a controlled environment to combat crime and fraud can be justified for restrictive measures³,
- gambling-related legislation is an area that has "significant moral, religious and cultural differences between member states". In the absence of EU harmonisation, each member state may determine what is required to ensure that the interests in question are protected. Member states are therefore free to set their own gambling policy objectives, provided that any restrictive measures do not go beyond what is necessary to achieve those objectives and must be applied without discrimination⁴.

Notably, these cases do not call for a general liberalisation of the European gambling market as a whole, but instead provide some grounds to force Member States to open their gambling markets, while at the same time allowing them to retain a degree of control over those markets based on "public interest". The concept of "public interest" is therefore something of a moveable feast that has the potential to be "creatively" used by member states. ISP blocking, financial transactions blocking, advertising restrictions and taxation

¹ *Questore di Verona v Diego Zenatti* ECJ 1999 C-67/98

² *Gambelli Ruling* ECJ 2003 C- 243/01

³ *Placanica, Palazzese, and Sorricchio* (Cases C-338/04, C-359/04 and C-360/04) ECR (2007)

⁴ *Liga Portuguesa de Futebol Profissional and Bwin International Limited (formerly Baw International Limited) v Departamento de Jogos da Santa Casa da Misericórdia de Lisboa* ECJ Case C-42/07

are all methods which some member states are still considering in order to continue restricting and controlling online gambling, while paying lip service to Article 49 by allowing EEA based operators to enter their heavily controlled national markets.

EU Directives: It is worth noting that Directives that follow the “country of origin” principle (i.e. where the gambling operator is based) expressly exclude gambling services from their remit (such as the E-Commerce Directive or the Services Directive). This exclusion ensures that gambling operators can be liable in the state where the player is based. However it also (conveniently) increases individual member state control (of course in the name of public interest) over foreign operators.

Conversely, Directives that do include gambling do not contain any harmonisation measures, but are more procedural in nature (such as the Distance Selling Directive or the Notification Directive).

Cynics might say that the exclusion of gambling services from “country of origin” EU Directives are themselves an indication of things to come, bearing in mind that EU Member States opposing the freedom of gambling services are relying on the principle of subsidiarity in line with the country of destination principle.

Controlled opening of gambling markets: Since 2006, the European Commission has accused several member states of infringing Article 49 and has taken action against state monopolies. As a (positive) result, gambling reform discussions are taking place in more than 17 member states. How these trends are changing the European landscape and the rules of the game can be best illustrated by developments in France and Italy.

- France will end its gambling monopoly in 2010 and will open the industry up to private competition. This “controlled” opening (supposedly in line with EU regulations) includes the requirement that interested parties obtain a French gambling licence and be regulated by the French gambling regulatory body. Licensed operators will be subject to stakes-based tax rates of 8.5% for sports betting, 15.5% for horse racing betting, and 2% for online poker. Licences will only be granted to operators established in the EEA (and these operators will not have to relocate to France). The French licence will only allow online gambling operators to offer their services to local players; players outside France will not be allowed to register. An amendment to the legislation also calls for all companies to close all their current French accounts for at least six months before they may apply for a license.
- The Italian Parliament has recently approved significant provisions that appear to open up the Italian market to EU operators and allow them to offer more products. Here again, a national (Italian) gambling licence will be issued to online gambling operators, who will be liable to local taxes: a 20% profit based tax on all new products and a turnover based tax on all existing products. The Italian online gambling market is open to online operators from EEA states and allows these operators to have their servers outside Italy, as long as they are located within the EEA. The Italian Licence is also restricted to Italian players in Italy and does not give the online gambling operators the right to accept and register players outside Italy.

Both France and Italy also intend to introduce responsible gaming standards in accordance with best practice

There are, of course, issues that both countries still have to address to comply with EC law (such as the reciprocal accreditation of operators already licensed in a EU member state). What is noteworthy however is the fact that the European Commission seems to

have accepted a double / triple / multiple-licensing model whereby a member state may issue separate local licences and impose local taxes. This (political) compromise may, of course, itself be capable of being challenged as a failure to respect the EU principle of “mutual recognition” of businesses and of the free movement of services under Article 49. That said, it is quite possible that the French / Italian approach will be adopted by other EU states wishing to open their markets to online gambling operators.

How does the UK compare with these countries? It is worth noting that taxation in Italy and France will be considerably higher than the current tax rates in the UK. Also, UK based operators will be able to enter these markets. However, this does not necessarily make them more competitive, because they will still be paying taxes in the UK (under their UK licence) as well as in each of these countries (under their French or Italian licence), while operators from Italy and France will be free to advertise to the UK without the need to apply for a UK licence or the need to pay any UK taxes. Fair play or foul?

WHITE LIST GAME RULES

Until now, the advantages for online gambling operators to be licensed in white listed jurisdictions (and not in the UK) are mostly attributable to their right to access the UK gambling market without being liable to pay UK tax, as well as their own favourable taxation regimes, coupled with unrivalled expertise and sophisticated technology. Two of these white listed jurisdictions have been of particular importance: Alderney and the Isle of Man, both of which are generally regarded as deserving of their reputation as centres of excellence for socially responsible online gambling and both of which, together with the UK, have set industry standards for player protection.

Understandably, recent EU developments have not gone unnoticed in these jurisdictions, which have reacted by adjusting their current regulations to meet these new challenges.

- Alderney, for example, has announced a new licensing regime with separate licences for B2C and B2B operators and which are described in detail elsewhere in this publication. B2C licences will be available for organisations that contract with players direct, while B2B licences are aimed at gambling platform operators who do not have direct interaction with players and who control the system on which the gambling takes place.
- The Isle of Man on the other hand, will shortly issue “sub-licences” (for a modest fee of £5,000). These sub-licences will be suitable for applicants intending to operate with an existing network operator licensed by the Isle of Man and are similar to Alderney’s B2C licences.

Why this sudden change? Although both jurisdictions have various reasons (i.e. major online gambling operators are now providing platform services to other online operators), the changes on the Continent must be seen in this context. EU states like France and Italy are introducing their own national gambling licences which, arguably, will be similar in nature to the B2C licences in Alderney and the sub-licence in the Isle of Man. Online gambling operators will be required to apply for licenses in Italy and France, but could theoretically, at the same time, channel players to a gaming platform in Alderney (B2B) or the Isle of Man (“master licence”). This division makes sense, because an operator who is required to be licensed in multiple jurisdictions need only use the one platform for all its businesses. This would not only save costs, but would also facilitate multi-player games where players are located in separate jurisdictions.

That said, both France and Italy have restricted platform, server and hosting facilities to EEA countries only. Jersey, Guernsey (including Alderney) and the Isle of Man are self-governing UK Crown Dependencies and not part of the EU or the EEA and so will not be entitled to provide online gambling services to any operators licensed in France or Italy, unless separate agreements are reached between them and the relevant Member States. It is likely that such agreements will be achieved.

There is more bad news, this time for Gibraltar, which is part of the EEA: in France, an amendment to the legislation in October suggests that only those online gambling operators that do not have subsidiaries or operations in tax havens (such as Gibraltar) can be considered for a French licence. Gibraltar is mentioned in this context, which may prevent many leading companies based in Gibraltar (including Ladbrokes and William Hill) from acquiring a French licence.

It is an ill wind that blows no good however, and the UK may yet benefit from the exclusion of white listed jurisdictions and/or the exclusion of Gibraltar, in that some online gambling operators may be forced to return onshore. At the moment however this is speculative, because the European Commission is to raise the Gibraltar exclusion with France. Nevertheless, the UK must address the ongoing migration of UK online gambling operators to white listed jurisdictions, as this issue will not be solved within the EU context, but by separate arrangements between the UK and white listed jurisdictions.

PRACTICAL ISSUES

The principles and developments touched on above are worth considering in a more practical context. Some of these considerations include the following:

- It is not enough for a UK Government review only to focus on white listed jurisdictions alone, without also considering the EEA angle. One example suffices to explain this: if a level playing field were created between the UK and white listed jurisdictions, the door would still be open for online gambling operators to migrate to Malta, as a member of the EEA with the right to advertise to the UK and with a more favourable tax regime and no requirements to contribute to Horserace Betting Levy.
- As to developments in the EEA, the French / Italian model of national licensing appears to be acceptable to the European Commission and it is therefore sensible to assume that other EU member states will follow this model, which will risk bringing about the end of the UK liberal approach. If the UK does not adapt quickly, it may witness a further migration, this time to the Continent. Another example suffices to explain this: if an operator intends to advertise to the UK and to France at the same time, it will choose France because France requires it to have a local licence in any event, while the UK does not. As the French (and Italian) Licences are restricted to local players only, French/ Italian licensees will not be allowed to accept players from the UK. However, with the UK's open market approach, online gambling operators could still set up a separate company in e.g. Malta and advertise to the UK from there, instead of applying for a UK licence. Conversely, if the same operator were to move to the UK, it would have to apply for a UK licence, pay UK taxes and would still have to do the same in France. This scenario would include migration from white listed jurisdictions, who would otherwise not be allowed to provide their services to the EEA. It is therefore logical that, regardless of the tax rates, as long as EEA operators can advertise to the UK without the requirement to be licensed by the UK Gambling Commission or to pay taxes in the UK, no operator will choose to be based in the UK.

- Can a level playing field be created for UK based operators without requiring foreign operators to apply for a licence in the UK, bearing in mind that foreign regulators do not have the power to enforce UK contribution requirements on their locally licensed operators? It is difficult to see how this can be done without requiring these foreign operators to be licensed in the UK as well (as per to the Italian and French model). What is questionable however, is whether the introduction of a licence for EEA operators would infringe Article 49. It is one argument for former monopolies to request a licence in order to open their markets and continue controlling, but another very different ballgame for the UK to retract from its liberal position on financial grounds and (effectively) infringe Article 49 by introducing a barrier to free trade unless it can justify this by the “Public interest” exclusions established in ECJ case law. That said, one possibility might be to require licences for EEA operators for as long as no other licensing regimes exist (i.e. before France and Italy implement their plans on the grounds that UK player protection is not met by current EEA states.) Once France and Italy introduce these responsible gaming standards however, the UK would have less manoeuvring space.
- As to the peculiarities of the French “controlled” opening, there may be further valid arguments for establishing breaches under Articles 81 and 82 of the EC Treaty, bearing in mind the request for closure of all online gambling accounts for at least six months before licence application, while the two state-run operations, Pari Mutuel Urbain and La Francaise de Jeux will most likely be allowed to continue offering their services. However, the main question is whether the European Commission will raise this issue with France in the first place and whether online gambling operators are prepared to fight their grounds after having to realise that Article 49 of the EC Treaty has been circumvented by member states.
- With regard to white listed jurisdictions, it would be less difficult for the UK to introduce a licence because, as stated above, these jurisdictions are not part of the EEA and Article 49 will therefore not apply. The consequences of such a move however will be useful only for so long as the UK manages to introduce similar provisions with regard to EEA operators. Introducing a UK licence for offshore operators may lead these operators (most of which originate from the UK) to re-locate to the UK. An alternative solution would be to introduce appropriate legislation to allow the servers (B2B) to be based in these jurisdictions while requiring the operators to apply for a (B2C) licence in the UK. Bearing in mind that the tax rates in both France and Italy are much higher than current UK tax rates, and bearing in mind that operators may be able to have servers in tax friendly white listed jurisdictions, the UK may be able to win the game after all.

Clearly there are numerous issues to consider in what is a complicated area that is regulated not only by “pure” gambling law, but also by competition issues and general EU principles that are intended to be applied to all member states.

CONCLUSION

Online gambling in the UK is carried out on a playing field that is currently far from level. The establishment in the UK of a (more) level playing field requires a detailed and thoughtful consideration by the UK Government of the impact in the UK and throughout the EU and EEA of the issues mentioned above. Ironically, the creation of a level playing field may require some un-levelling of the current pitch, although this rectification process is itself liable to be challenged as being uncompetitive. There is, of course, no easy way forward, particularly given the number of variable factors and the amounts at stake for

individual country exchequers. The UK review findings are, however, due to be submitted to the DCMS in 2010. It will be interesting to see what they are and what other factors (as well as those referred to above) may have altered the playing field in the meantime.

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