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Multi-jurisdictional gambling: legal and partnership issues

Simon Halberstam, a Partner at Kingsley Napley LLP, discusses how the recent move by online gaming operators into gaming software and the gradual shift towards market liberalisation (at least in Europe) have changed the nature of multi-jurisdictional partnerships in the industry. One constant, however, is the myriad of legal and regulatory burdens for which operators must be prepared.

In defiance of the recession, over-bearing regulation and sometimes outright prohibition, the online gambling industry continues to grow, with a recent estimate by H2 Gambling Capital valuing the global market at around $20 billion. In this time of economic strife, calls to lift restrictions and harness the growth potential and revenue generation of this industry have reached a crescendo.

Historic hostility to online gambling

Such restrictions have been imposed both for political and economic reasons. It is well known that, during the recent era of conservative political dominance, the US government has smothered the online gambling industry via strict enforcement of the Federal Wire Act 1961 and the passage of the Unlawful Internet Gaming Enforcement Act 2006 (UIGEA).

The European Union is the largest single market in the world and principles of free trade between Member States underpin the whole concept of the Union. In trying to extend the free market to online gaming, however, the EU Commission has come into conflict with many Member States determined either to prohibit online gaming altogether or restrict it to state-owned monopoly providers. A notable example is that of Germany. The German Laender (federal states) passed an Interstate Treaty on Gambling (ITG) that came into force on 1 January 2008, effectively banning all forms of online gambling and preserving a profitable state monopoly in sports betting and lotteries. Many other Member States followed similar policies including France, Greece and Spain.

Limited moves towards liberalisation

There were attempts in the previous Democrat-controlled Congress to push the US towards regulation of online gambling in place of the effective ban that exists at the moment. Such attempts did not gain enough traction to force a change in the law. The new Congress - with a House of Representatives now controlled by conservative Republicans - is unlikely to move towards liberalisation. For now at least, America is choosing to forsake the $12 billion in revenue that Goldman Sachs estimate online gambling could inject into the US economy.

In Europe, there are signs that the global recession has, in concert with sustained pressure from the EU Commission and recent decisions by the European Court of Justice (ECJ), strengthened calls for a liberalisation of the market. Countries operating state monopolies have seen their revenues decline in recent years while those embracing liberalised markets have prospered. The Association of German Lotteries released figures showing that since the passage of the ITG, German gambling revenues have actually decreased by around 30%. In marked contrast, following its early conversion to regulated but open online gaming, Italy has become the biggest market in Europe. The Italian Gaming Authority released figures showing 2010 turnover at over €4.8 billion, a 28.2% increase year from the previous year.

The global downturn has led to a reassessment of the situation from a number of formerly protectionist Member States. In the face of squeezed public finances, repressing a seemingly recession-proof industry - the regulation of which could create a valuable new revenue stream for government coffers - seems increasingly difficult to justify.

For example, Denmark is now moving towards a partial liberalisation of the online gaming market, lifting restrictions on online casinos and sports betting and replacing them with a licensing system. Lotteries remain under a state monopoly. As discussed below, new operators are moving into the Danish market.

Germany is also considering moves to open up. Where they were once united, the Laender are now divided, with several states pushing for a form of regulation to replace the ITG when it expires at the end of this year. In the recent Carmen Media case, the ECJ declared the German monopoly incompatible with the freedom of establishment and freedom to provide services enshrined within Articles 49 and 56 of the Treaty on the Functioning of the European Union. This landmark decision makes German law difficult to enforce and has led to further demands to liberalise the market.

UK going contra-flow?

The UK remains one of the most liberal regulators of online gambling in Europe, with overseas operators able to offer services to UK residents and advertise those services in the UK provided they are based in the European Economic Area or a ‘white-listed’ jurisdiction. However, although there have been proposals to introduce a licensing requirement for overseas operators, the coalition government does not seem inclined to move towards such a system in the near future.

France has partially liberalised its online gambling market but the requirement for operators to purchase a 'betting right' from the organisers of sporting events has caused consternation. Nevertheless, overseas operators such as PokerStars, the world's largest poker website, have now obtained licences.

In China, all gambling (save for a government-backed state lottery) is illegal. There is speculation that as China's wealth increases, the laws may be relaxed to accommodate the burgeoning middle class. Some overseas software companies have provided technology services to the (offline only) state lottery, however China is set to remain a closed territory to online gaming operators for the foreseeable future. Russia remains equally restrictive, with a blanket prohibition on any forms of online gaming.

The changing nature of partnerships

Horizontal partnerships

In the past, those companies wishing to expand overseas often opted for partnerships with operators established in target countries, in order to sidestep legal restrictions and comply with the various regulatory regimes.

An example is the agreement reached last year between PokerStars and Belgian casino operator Circus Groupe which allows Belgian customers access to the PokerStars site. Belgium is among the more restrictive EU countries as regards online gaming, as any provider of online services must also have a land-based presence in Belgium. This deal allowed PokerStars to sidestep the legal obstacles and enter the Belgian market. However, as more territories open their doors to online gaming, such partnerships look set to become increasingly unnecessary.

Repressing a seemingly recession-proof industry - the regulation of which could create a valuable new revenue stream - seems increasingly difficult to justify

The growth of technology services and vertical partnerships

Operating in the uncertain market conditions described above was difficult for operators, with limited opportunities for overseas growth. Many operators chose to diversify their offering beyond the provision of online gambling services to consumers, by creating 'B2B' divisions providing technology solutions to other online gambling operators. These divisions either license use of an 'off the shelf' software platform or offer more tailored solutions to specific client needs.

In 2007, UK operator 888 launched Dragonfish as its B2B arm. This division has been instrumental the formation of many well-known gaming websites, such as Foxy Bingo, and is a key part of 888's business portfolio. Other well-known operators to have B2B divisions include PartyGaming and Austrian operator Bwin.

The growth in this gaming software sector is now driving the formation of multi-jurisdictional vertical partnerships, rather than conventional partnerships between traditional operators. Offline operators in newly liberalised markets are now turning to these established technology providers to expedite the formation of their online presence.

There have been many partnerships of this nature in recent years. Dragonfish partnered with US offline gaming giant Hannah's Interactive Entertainment Inc to roll out the World Series of Poker brand online in the UK. In January 2010, PartyGaming signed a five-year contract with Danish lottery operator Danske Spil to provide the platform for its online poker and casino games. Betsson, a Maltese-registered but Swedish-owned operator, signed a deal in February to enter the Italian market via a B2B deal with IT company Alma Viva, owners of the Gbet.it website.

Mergers

Rapid changes in the online gaming firmament have also precipitated big money mergers between operators as they look to consolidate their positions and prepare for the future. In December, offline-based Ladbrokes entered into fresh talks (previous discussions in 2007 broke down without a deal) to acquire online operator 888 in a deal worth approximately £240 million.

More concrete is the decision last month by the shareholders of PartyGaming and Bwin to approve a merger between the two operators - a move set to create an industry giant with estimated net revenues of €700 million.

Legal issues

There are still significant barriers to entry in overseas markets, both for gaming operators and technology service providers. There has been little or no harmonisation of regulation, and operators looking to expand overseas will be confronted with different regulatory and legal burdens in each target territory.

Promotion

Countries differ in their perspectives on this issue. Generally, however, operators actively targeting an overseas audience will need to comply with local law, whereas if a website is accessible by people in a foreign jurisdiction but is not targeting their consumers, then repercussions are less likely. This reflects the general trend in online regulation. Any operator looking to expand overseas will need to take specialist advice on how to comply with local law, as not all jurisdictions are as lenient on foreign advertising as the UK regime discussed above.

Contracts with consumers

Operators have substantial regulatory exposure if they are not fully compliant with all relevant EU and national laws and regulations. They must be careful to minimise exposure and ensure compliance via tightly worded customer contracts. Clear terms and conditions must be drawn up for each game to be offered. Foreign operators looking to move into the UK market should be aware of and prepare for a variety of issues including consumer protection, distance selling, jurisdiction and liability. UK operators looking to expand overseas must ensure that their terms and conditions would withstand scrutiny in the prospective territory as what may be a legal contract in the UK could contravene the law of the country in which the overseas consumer is resident. Operators will want to minimise the risk of enforcement proceedings against them in foreign courts. It is crucial to ensure that a cross-border contract between the operator and punter would be deemed to be properly formed in both territories, and compliant with both sets of consumer protection legislation. For instance, a lawful contract between an 18-year-old customer and a UK gambling operator would be illegal in a country where the age of majority is 19.

B2B contracts

The form of remuneration will need to be considered (i.e. profit share or fixed fee), as will non-compete provisions and a clear stipulation by operators that the contract is subject to their home jurisdiction.

It would be almost impossible to comply with the laws and regulations of every country. However, operators can obtain some protection from properly drafted contracts containing exclusion clauses and territory statements restricting the offer to citizens of named countries.

Other contractual issues which operators should address include fraud, termination, communication of offer and acceptance, revocation and lapse of offer. Cross-border transactions are likely to complicate the legal scenarios in such matters.

Operators looking to expand overseas should seek specialist advice to ensure that any expansion runs as smoothly as possible.

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