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Gambling Update

Developing Issues for the Gambling Industry

January 2013

Welcome to the first edition of our Gambling Update for 2013.

Launched in 2012, the Gambling Update is a periodic newsletter from the Squire Sanders gambling team highlighting a selection of developments and news items from the gambling world designed to give industry players, clients and contacts a swift resume of pertinent matters which we think may be of interest. If you would like further information about any of the items mentioned below, please feel free to contact Carl Rohsler whose details are at the foot of the update.

In This Issue

A Look Back at 2012

We review some of the key developments in the industry last year including:

- Camelot's judicial review challenge to the Health Lottery.
- The implications for online terms and conditions of the High Court's decision in *Spreadex v Cochrane*.
- The increase in allegations of competitor copying of online games (and ask whether your games are adequately protected).

A Look Ahead to the Challenges Facing the Industry in 2013

In particular, we assess how the regulatory landscape is likely to change in the coming year in light of:

- The Court of Justice of the European Union's (CJEU) recent ruling in *HIT and HIT LARIX v Bundesminister für Finanzen.*
- The progression through the UK Parliament of the Gambling (Licensing and Advertising) Bill.
- The European Commission's Action Plan on enhanced cross-border co-operation.

Some New Year's Resolutions

Some risk management steps you may want to take in 2013.

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A Look Back At 2012

Camelot Challenges the Health Lottery

Probably the most high profile and newsworthy UK gambling case in 2012 was Camelot's challenge to the Health Lottery. The matter ended in the High Court, which was critical of Camelot's approach and which unhesitatingly upheld the legality of the Health Lottery Scheme. We have been advisers to the Health Lottery since its inception.

Background

The Health Lottery was launched in October 2011. It was established as a multiple society lottery scheme designed to maximise the scale of prizes and proceeds whilst staying within the statutory limits. The scheme comprises an External Lottery Manager (ELM) providing lottery services to 51 large societies. Initially, The Health Lottery ELM Limited was established (THL). Subsequently, 51 Community Interest Companies (CICs) were set up. The CICs were entirely independent of each other (although they each had the same three directors) and the objective of each CIC was to raise money for good causes, specifically health projects, in different regions of the UK by promoting a lottery. Each CIC outsourced the management and day to day conduct of its lottery to THL. In addition, the People's Health Trust was set up as a registered charity to receive the lottery funds collected by each of the CICs and channel those funds to the specific health projects chosen by the CICs for their respective geographical areas. Following a hearing before its Regulatory Panel, the Gambling Commission licensed THL to act as an external lottery manager and each CIC was granted a lottery operating licence.

The Structure

This multiple society lottery scheme had to operate within the limits imposed by the Gambling Act 2005 (the Act). The reason why it was regarded as strategically clever was that it did so in an entirely legal but creative manner, such that it was able to truly compete in prize terms with the scale of the National Lottery. Specifically, section 99 of the Act imposed certain mandatory conditions on the lottery operating licences of the CICs. These conditions provided that the proceeds of the lottery promoted by each CIC (proceeds being the total amount accrued from the sale of lottery tickets) must not exceed £4 million and the aggregate proceeds in a calendar year must not exceed £10 million. A further condition was that the maximum prize should not be more than £25,000 or, if more, 10 percent of the proceeds. The result of these conditions was that the available prize fund would be relatively low when compared with the National Lottery, making it more likely that people would participate in the National Lottery, rather than the Health Lottery. This would adversely affect the Health Lottery's ability to raise money for good health related causes.

However, the structure used for the Health Lottery mitigated this problem. Each week, at least one CIC would promote the lottery, with additional CICs joining in as more tickets were sold. This prevented any CIC from exceeding the £4 million threshold for a single lottery. When a CIC sold at least £1 million tickets, sales would be frozen and a second CIC would take over the promotion. Once the second CIC reached £1 million in ticket sales, a third CIC would come on board, and so on until sales were exhausted or the time for the draw had arrived. Not only was the £4 million threshold not exceeded but it also meant that the Health Lottery could offer substantial prizes.

Camelot's Response

Camelot wrote to the Gambling Commission on a number of occasions claiming that the Health Lottery did not comply with the requirements of the Act and asking that it both review how the lottery worked in practice and revoke the licences granted to the CICs and THL. Camelot had two key arguments. One was that although the scheme might technically comply with the financial limits in section 99, in practice the limits were exceeded. The structure of the lottery was simply a device to avoid the section 99 limits and so, in Camelot's opinion, was illegal. Camelot's second argument

related to section 19 of the Act. Section 65 of the Act allowed the Commission to grant lottery operating licences only to "non-commercial entities", defined in section 19 as an entity with "any non-commercial purpose other than that of private gain". Each CIC was paying THL to promote its lottery on its behalf. Camelot argued that this meant that each CIC was, in fact, established for a commercial purpose (helping THL to make a profit) and so each CIC was ineligible to hold a lottery operating licence.

In response, the Gambling Commission initially declined to review the Health Lottery. The Commission's view was that it had exercised its discretion to grant licences to THL and the CICs in full compliance with its statutory obligations to ensure that gambling is conducted in a fair and open way. The Health Lottery might be exploiting a loophole in the Act, but any perceived loophole should be filled by Parliament via legislation and not by the Gambling Commission.

Camelot sought judicial review to quash the Gambling Commission's decision not to review the licences and to obtain an order requiring the Commission to undertake a review.

Judicial Review

In a clear and relatively brief judgment, the High Court refused Camelot's application to proceed with its judicial review claim. It criticised Camelot for delay. The court said that Camelot should have brought these proceedings within three months of becoming aware of the facts giving grounds for the claim. The evidence had shown that Camelot had known of the relevant facts since at least the date of the launch of the Health Lottery (February 2011) but it had chosen not to bring proceedings until March 2012. Camelot asked the court to exercise its discretion and extend the time in which a claim could be made. The court refused to do so, stating that Camelot had "not been candid" about when it had first appreciated that it had grounds for judicial review. During the proceedings a letter had come to light in which Camelot had raised the Health Lottery with the National Lottery Commission. This showed that it had relevant knowledge about the Health Lottery earlier than Camelot had claimed. Camelot had not disclosed this letter to the court.

The High Court went on to say that, despite the delay, it might be minded to rule in favour of Camelot if it was satisfied that the Health Lottery in fact operated outside the requirements of the Act and was therefore illegal. The court conducted a review of the structure of the Health Lottery and the terms of sections 99 and 19 of the Act and concluded that it was entirely satisfied that the lottery complied with the Act and was legal. With regard section 19, the court was satisfied that merely paying THL for their services did not turn the CICs into commercial entities incapable of holding a licence. Furthermore, on the question of the financial limits in section 99, the court found that the CICs were entirely separate legal entities and so, contrary to Camelot's claims, it would not be appropriate to aggregate their proceeds for the purposes of assessing whether the limits in section 99 had been exceeded. The court agreed with the Gambling Commission that the lottery may be exploiting a loophole in the law but it was a political question whether that loophole needed to be filled. In its judgment, when granting the licences, the Commission properly exercised its discretion and acted lawfully.

Comment

Whilst the legality of the Health Lottery is beyond doubt, the broader question remains whether lottery structures technically compliant with the Act but, in practice, arguably avoidant should be permitted. The Gambling Commission described the Health Lottery as "the gambling equivalent of a tax avoidance scheme that exploits loopholes in the legislation". In the area of tax, it has long been an established principle that everyone is entitled to manage their affairs to pay the least tax possible. Recently, that principle has come under fire (Starbucks and Amazon are cases in point). This case mirrors those issues. Is technical compliance with the Act enough or are gambling operators required to comply with the unwritten 'spirit' of the Act? It remains to be seen whether the government will take action following this decision. In the meantime, the judgment makes interesting reading and is available here.

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Terms and Conditions After Spreadex v Cochrane

Spreadex Limited v Colin Cochrane was a decision of the High Court back in May 2012 concerning the online terms and conditions of spread betting company, Spreadex.

The facts of the case were that Colin Cochrane opened an online account with Spreadex. He was given the option to view Spreadex's terms and conditions (which he did not do) but he did click on 'agree' to signify his agreement to them. Clause 10(3) of the terms and conditions provided "… *you will be deemed to have authorised all trading on your account*." Subsequently, £50,000 in losses was accrued on his account, which Mr Cochrane claimed were due to his girlfriend's child having made trades without his knowledge. Spreadex sought to recover the £50,000 from Mr Cochrane relying on clause 10(3). However, Spreadex's claim failed, the High Court finding in favour of Mr Cochrane. It held that there was no contract between Spreadex and Mr Cochrane as Spreadex had not provided any consideration (giving access to the online platform was not enough as this access could be denied at any time). Accordingly, clause 10(3) was not binding on Mr Cochrane. The court went on to say that even if there had been a contract, Mr Cochrane would not have been bound by clause 10(3) as this was an unfair term under the Unfair Terms in Consumer Contracts Regulations 1999 because of the significant imbalance in the parties' rights and obligations (in the court's view the contract imposed no obligations on Spreadex and gave the customer no rights). In addition, Spreadex would have been 'quite irrational' to have assumed that Mr Cochrane had read clause 10(3) (embedded in a 49 page document full of "closely printed and complex paragraphs") or indeed any of the terms and conditions.

This case has obvious implications for online operators. It demonstrates that website terms and conditions must be fair, explicit, easily accessible and easy to read. It can be difficult to give general guidance on what will pass this test, as terms that meet all of these criteria in one particular set of circumstances may not do so in another. However, as a general rule of thumb, it should be assumed that the terms and conditions will be read by the general public, who are consumers with no legal knowledge and that any significant burdens (such as, for example, verifying the identity of the person accessing an individual account or their age) should be placed on the operator rather than the consumer.

In addition, the case raises the wider, and as yet unresolved, question of whether online terms and conditions are binding at all when they reserve the right for the service provider to withdraw the service at any time.

Competitor Disputes

We have been seeing a number of online gaming companies squaring up to their competitors alleging intellectual property infringement in game formats and characters. The dispute between Electronic Arts (EA) and Zynga is one example. In August, EA issued proceedings against Zynga in the US alleging that Zynga's new game, The Ville, infringed copyright in EA's game, The Sims Social. EA alleged that the games were "unmistakably similar" and "largely indistinguishable" to the casual observer. It said that Zynga's "design choices, animations, visual arrangements and character motions had been directly lifted from The Sims Social". The claim is still ongoing. Similar allegations were made by Nova, producer of the Pocket Money arcade-style computer game against Mazooma in respect of its games, Jackpot Pool and Trick Shot. In addition, allegations were made that the characters in Gamesey's Bingo Friendzy, available on Facebook, bore a striking resemblance to the popular Angry Birds.

It is well established that copyright protects only the expression of ideas, not ideas themselves. However, in practice, the line between idea and expression can be difficult to draw. Although the concept of ideas versus expression has been analysed by the courts in the context of films and books, there is very little guidance on the position for games. The result is that there remain questions as to the extent to which copyright will protect game formats and specific game graphics.

In view of this uncertainty, games developers should not rely solely on copyright to protect their game formats. We are advising a number of clients in this field to use registered designs to protect the visual appearance and graphics of their games. Registered designs are relatively quick and cheap to obtain. In addition, existing use does not necessarily prevent a registration being obtained and protection can be obtained both within and outside the EU.

Challenges Facing the Industry in 2013

The CJEU Ruling in HIT LARIX

Although this was a ruling of the Court of Justice of the European Union (CJEU) back in July 2012, the impact of the judgment is likely to be felt in 2013 and beyond.

This case stemmed from the laws in Austria on the advertising of gambling. Austrian laws provide that foreign gambling operators may not advertise in Austria unless they have prior permission to do so from the Bundesminister für Finanzen (the Austrian Federal Minister for Finance). Permission will only be granted where the operator can show that the legal protection for gamblers provided in their home territory "at least corresponds to" that in Austria.

HIT and HIT LARIX operated casinos in Slovenia. They applied for permission to advertise in Austria but this was refused on the ground that they had failed to show that legal protection for gamblers in Slovenia at least corresponded to that in Austria. HIT and HIT LARIX brought proceedings in Austria challenging this decision. The Austrian court asked the CJEU to rule on the wider question of whether Austrian law was compatible with the freedom to provide services guaranteed by EU law.

The CJEU held that it was. In essence, it ruled that each Member State will have specific moral, religious and cultural views on gambling and so each was free to regulate gambling (including gambling advertising) as it chose, and this would not impact on the freedom to provide services. This was provided that the regulations were proportionate to providing the protections that a particular member state wanted to have in place and that the regulations did not place an excessive burden on operators outside that territory.

This ruling has implications for gambling operators. In effect, the CJEU was sanctioning member state by member state regulation of gambling, so inherently blessing a national model of regulation, like that currently seen in France and Italy, broadly justified on the grounds on 'public interest'. Such a model is only likely to increase the regulatory and administrative burdens faced by operators. See, however, information about the European Commission's Action Plan (below).

Gambling (Licensing and Advertising) Bill

This Bill was introduced by the UK government at the end of 2012. If the Bill becomes law, it will introduce a national system of gambling regulation, like that envisaged in the HIT LARIX case.

The Bill impacts online gambling. Currently, under the Gambling Act 2005, a licence from the Gambling Commission is only required to provide gambling services in the UK if an operator has at least one piece of remote gambling equipment located in Britain. This means that a gambling operator based outside Britain (say, Malta) who provides remote gambling services to consumers within Britain via a website needs a licence from the Gambling Commission if a piece of its remote gambling equipment (e.g. a server) is based in Britain. However, if all of its remote gambling equipment is located outside Britain, no licence is needed.

The Gambling Act also regulates how gambling services are advertised in the UK. Operators based outside the UK, but regulated in an EEA state or Gibraltar can freely advertise in the UK. Operators based in the Isle of Man, Alderney, Tasmania, Antigua and Barbuda are also able to advertise in the UK by virtue of being included in a 'white list' created by the Secretary of State. Operators regulated outside the EEA or the white listed countries cannot advertise in the UK.

The Bill would amend the 2005 Act so that all operators advertising to or transacting with UK consumers would need to be licensed by the Gambling Commission. They would also have to pay a compulsory point of consumption gambling tax, effectively taxing online operators on the basis of the location of their customers regardless of where the operator is based. The white list would be phased out.

The general consensus in the industry is that the real impetus for this Bill is the desire to tax online operators based outside the jurisdiction. The documents accompanying the Bill justify the changes it introduces as the need to give greater protection to UK consumers, arguing that the current system is flawed. However, the documents produce no clear evidence that UK consumers are being harmed by the current system of regulation. Nor are they specific about the flaws in the current system.

Requiring operators from outside the jurisdiction to be licensed by the Gambling Commission provides the much needed 'link' between the UK and the operator, on which a tax charge could be based. New tax legislation needs to be approved at EU level. Generally it will be approved if the changes it introduces are in the public interest (other than merely financial benefits). It is probably no coincidence then that this new point of consumption tax is included in a piece of legislation which is ostensibly for consumer protection.

Should the Bill become law, the government's plan is for there to be light touch regulation by the Gambling Commission relying, for example, on work done by regulators in other territories so as to avoid duplication of effort. This is very much in line with the European Commission's 'Action Plan' (see below). This does, however, beg the question why additional regulation is needed at all if only a light touch is required.

The Bill must still pass through a number of stages before it can become law. It is currently before the European Commission which will assess its compliance with Treaty obligations. Then it will be subject to scrutiny by the Culture, Media and Sport Select Committee. It must also withstand scrutiny by both the House of Commons and the Lords and defeat any challenge to its legality on the basis that it may restrict freedom to provide services in the UK (although the HIT LARIX case suggests that any such claim would be difficult).

The likely implementation date is December 2014. For now, operators are advised to simply watch this space.

EU Action Plan

In October 2012, the European Commission published its Action Plan for online gaming. This is not the clearest document ever to have come out of the EU in terms of setting out exactly what steps the Commission intends to take in 2013 and beyond. However, what is clearer is that the Commission intends to lead some joined up thinking on the regulation of online gambling in the EU.

EU law prohibits a Directive harmonising gambling regulation across the EU. This prohibition makes sense when one considers that, culturally, gambling is viewed very differently from one member state to another. However, the Commission has recognised that in the current financial climate member states will be cutting back on the administrative expense of regulation and, in its Action Plan, seeks to encourage member states to work together to share the ongoing administrative burden. For example, where a gambling operator has been thoroughly scrutinised and licensed by a regulator in one member state, other member states in which the same operator subsequently applies for a licence are encouraged to rely on the checks carried out by the first regulator in deciding whether to grant a licence rather than repeating the same or very similar checks.

The Action Plan is a 'back door' Directive using the mechanism of "enhanced co-operation". It does not do away with the national model of regulation permitted in HIT LARIX, but it does ease the administrative burden for regulators and operators looking to operate cross-border. As such, it is to be welcomed.

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New Year's Resolutions

The stories above are only a sprinkling of the snowstorm which is gambling news. But what about some practical suggestions for the busy in-house counsel?

- Take a moment to review standard terms and conditions with customers. The Unfair Terms in Consumer Contracts Regulations are increasingly being used as a basis for attacking and undermining these types of contract. We share your pain on this one – because as lawyers we recognise that there is only a certain amount that one can do to simplify and draw attention to key points in what are sometimes inherently complex documents. But it is always worth trying.
- Does your company have a programme for registering designs for key aspects of new games such as characters, pay tables and so on? Registered designs are the Cinderella of IP law – potentially very powerful and extremely cost-effective, but surprisingly seem to be the preserve of fabric and furniture designers, and their potential is hardly ever exploited to the full. If you would like to talk about how registered designs could serve and protect your business, please feel free to call for a (free!) chat.

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