

Press Release

Impact of the Federal Constitutional Court's decision on the German betting market

Objective analysis of the repercussions, the winners, and potential future scenarios

Munich/London, 29 March 2006: The betting industry has waited a long time for the decision Germany's Federal Constitutional Court issued yesterday. However, neither the state-run nor the private suppliers have reason to feel victorious.

In fact, today's decision by the German Federal Constitutional Court should not have come as a surprise to betting industry experts. The decision was certainly one of the more likely outcomes considering all possible scenarios, and it is similar to the decisions issued by the highest courts in other European countries (e.g., the Netherlands and Scandinavia).

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1 Summary of the most important points of the Federal Constitutional Court's Decision

A brief summary of the most important points of the Federal Constitutional Court's decision:

- **Currently, the state monopoly (Oddset) does not focus on channeling the urge to gamble and preventing gambling addiction:** The state's monopoly in betting is based on the principle that the state should ensure that games of chance are channeled and should thus minimize compulsive gambling. It is precisely this focus the Federal Constitutional Court found the Bavarian state betting offers do not have: *"Rather, what is decisive in the present context is that it [the advertising of the state provider] is not designed to channel an already existing urge to gamble toward the state-run betting offers but instead it provides incentives for and encourages betting."* The court also rejected the state's fiscal interest in games of chance but he court instead considers this fiscal interest as the driving force behind the current state offers: *"the sportsbetting offer Oddset clearly also pursues fiscal purposes."*
- **The state can retain their monopoly if by the end of 2007 it returns to a focus on channeling the gambling urge:** The Federal Constitutional Court set the state-run provider a deadline of 31 December 2007; by that date it must orient its market behavior *"consistently toward the goal of fighting betting addiction and limiting the betting urge."* This includes primarily *"content criteria regarding the type and design of sports bets as well as guidelines for limiting marketing."* Only if the state-run provider does not meet this condition of limiting its activities by the deadline in 2007 will it lose its monopoly position, and the federal states will then have to allow *"legally standardized and controlled licensing of private betting enterprises to organize bets."*
- **For the time being, private betting offers are prohibited:** The Federal Constitutional Court has ruled that until the end of 2007 *"commercial betting offers from private betting enterprises and the brokering of bets that are not organized by the state can continue to be considered prohibited and can be stopped by means of regulatory laws."*

Even though the Federal Constitutional Court based its decision in the case under consideration on the betting products offered in Bavaria, its opinion can also be applied to other federal states and is also relevant to other products offered by the state-run providers (e.g., lottery, keno).

2 Consequences for state-run providers and Oddset

Ever since the ECJ's "Gambelli" decision – if not already before that – the state monopolies have had to put up with the accusation that their focus is more on increasing their turnover and profit rather than on their original mission that legitimized their monopoly position in the first place, namely, channeling gambling. Now the Federal Constitutional Court has joined the highest courts of other European countries (e.g., the Netherlands, Italy) in finding that the state demonstrates an excessive fiscal interest in betting, and the court has therefore called upon the state to return as soon as possible to the original focus on channeling gambling.

The state-run providers have been expecting this criticism and have already begun to take small steps in the direction of prevention in the past year (for example, brochures on the danger of gambling addiction, adapting their public relations presentation of company objectives and values). But the Federal Constitutional Court's decision calls for much more radical breaks with the past:

- **Less advertising:** Reduction of advertising spending in all media; this will affect print advertising especially.
- **Restriction of product portfolios:** In the future it will be difficult to justify new products as necessary product extensions.
- **Reduction of retail sales:** A reduction of the ca. 26,000 retail outlets in Germany is an easily imaginable consequence of the court's decision. In addition, the planned increase in alternative sales channels (e.g., sales via supermarkets and gas stations) is now also called into question.
- **Expansion of sales via Internet and cell phone:** As MECN sees it, particularly the expansion of betting product sales via the Internet must be interpreted as channeling the urge to gamble. State-run providers must be able to compete with their own viable alternatives against offshore Internet betting offers. The same applies also to the growing market of mobile betting.

An objective control committee – who monitors compliance with the conditions imposed by the Federal Constitutional Court?

An important question the court has not fully answered is who will be responsible for monitoring the activities of the state-run providers and verifying that they are geared toward channeling the gambling urge. Up to now monitoring was essentially in the hands of the federal states (e.g., the Bavarian secretary of the treasury), but according to the Federal Constitutional Court, this arrangement seems to have failed. True, a control through the state owners is difficult since they are, after all, in a conflict of interests: more revenue for the state vs. channeling the gambling urge. This is also pretty much the court's assessment of the situation: *"The law must ensure, by means of suitable supervisory authorities that are sufficiently removed from the state's fiscal interests, that these conditions will be complied with."*

As an alternative, a kind of control committee could be set up that consists of objective industry experts, such as the "Forschungsstelle Glücksspiel" (research center for games of chance) and of insiders of the betting and gambling industry. Among the essential tasks of this committee would be the approval of new products and sales channels and the evaluation of advertising design and expenses. The rather simple directive regarding *"limiting marketing,"* as the court puts it, is too general. Instead, regulating advertising and marketing always depends on complex contexts and constantly changing conditions.

Possible framework for regulating the state monopolies

As early as summer 2004, right after the ECJ's decision in the Gambelli case, MECN published its study *"The European Union and its Impact on State-Licensed Gambling Monopolies,"* which provides a framework that can be used in making decisions regarding possible expansion through extending the product portfolio, the sales channels, and advertising.

In essence, it is based on two factors that determine the extent to which an expansion strategy is justified (legitimate):

1. **Level of need** - If there is no need for a product or sales channel, then state-run providers should, of course, not start offering them. This criterion restricts state-run providers because they can not create a demand themselves through their product design and advertising.
2. **Number of illegal offers** - Even when there is a need, for example, for a betting product but no illegal or foreign provider can meet this demand, the state should not be allowed to expand its product portfolio.

3 Consequences for the state – Monopoly or liberalization?

The state and the individual federal states now hold the reins and can determine in which direction the betting market will develop in the future. Even though they might at first glance prefer a state monopoly, strict implementation and enforcement of the revenue-limiting conditions set by the Federal Constitutional Court would mean reduced revenues for the budgets of the federal states and the various sports associations. Therefore, it is not at all certain that all federal states will continue to oppose liberalization once they have thoroughly analyzed the fiscal consequences of a restricted monopoly.

After all, some federal states have long since begun to privatize their gambling industry. For example, since 2005 the casinos in Lower Saxony have been owned by Casinos Austria, and this example in particular found the states in East Germany ready and willing to listen. Moreover, tax revenues from the betting industry can amount to significant sums as the UK market demonstrates.

In addition to adjusting the focus on channeling the gambling urge, another possible scenario would be therefore the privatization or sale of the state betting monopoly to a private company. Such a privatized provider would then probably have a very good chance to establish itself successfully in a privatized, regulated, and liberalized market.

4 Consequences for private betting providers and brokers from other EU countries

Regardless of possible additional decisions by the ECJ or the EU Commission, the opinion of the Federal Constitutional Court is unambiguous: *“The commercial organization of bets by private betting companies and the brokering of bets that are not organized by the Free State of Bavaria can continue to be considered prohibited and can be stopped by means of regulatory laws. Whether during the transition period there also is penal liability according to § 284 StGB is up to the criminal courts to decide.”* In summary, the court’s key statements are:

- **All sports betting offers except for the state product Oddset can be prohibited** - Since in Bavaria only Oddset is *“organized by the Free State of Bavaria,”* then according to the court, all other betting offers (with the exception of betting on horse races) can be prohibited. It is thus up to the local regulatory authorities whether to enforce this in their jurisdictions; thus, in many cities betting shops could be closed down.
- **No statement was made regarding penal liability** - The decision on whether there is penal liability according to §284 StGB is up to the individual criminal courts.

5 Consequences for holders of licenses issued by the former GDR

There are 4 private betting licenses in Germany that have retained partial validity because of the Unification Treaty. In addition, there are many brokers brokering to these holders of licenses issued by the former GDR. Whether these licenses are valid beyond their region, that is, nationally, has already been the subject of legal disputes in the past. And the interpretations of today’s court opinion (*“that are not organized by the Free State of Bavaria can continue to be considered prohibited and can be stopped by means of regulatory laws”*) diverge widely:

- *“The Federal Constitutional Court’s decision has no effect on the sports betting business of our German business.”* (BetandWin, holder of a license issued by the former GDR).
- *“The market will not change much”* (Holger Frister, spokesperson of Sportwetten Gera – license issued by the former GDR).

- *"In this regard Oddset is particularly pleased that the court has now clarified that the organization of bets by private enterprises and the brokering of bets that are not organized by the Free State of Bavaria will continue to be prohibited and can be stopped by means of regulatory laws."* (Wolfgang Feldner, marketing director, state monopoly Oddset).

Perhaps the Federal Constitutional Court was not quite sure what its precise wording implied, but licenses issued by the former GDR are not *"organized by the Free State of Bavaria"* and can thus also be prohibited. If one follows closely the exact wording of the court's opinion and replaces the word "Bavaria" with "North-Rhine Westphalia," ... one can see that the Federal Constitutional Court today also implicitly restricted the national validity of the licenses issued by the former GDR and has restricted brokering to them.

6 The winners in the Federal Constitutional Court decision

Although the decision will be much discussed in the coming weeks, two winners are already clear:

- **Small, offshore Internet betting providers that cannot be regulated** - The state's betting offers must be limited, and the future of serious and large private betting operators is uncertain. The ones benefiting from this are above all the offshore providers in the Caribbean. ... They cannot be regulated by German court decisions or by the Securities and Exchange Commission.
- **The state and the individual federal states** - They now hold the reins again and can determine in which direction the betting market will develop. They will surely continue to be confronted again and again with decisions issued by the ECJ and the EU Commission regarding the harmonization of the European gambling and betting markets, but the Federal Constitutional Court has clearly given them moral support.

Whether the state and the individual federal states will be in favor of a monopoly is not yet clear – the options of privatization and liberalization will surely continue to be discussed intensively in the coming months (see also section above).

7 Studies on this subject

On this topic MECN has published the following studies:

- "The German Betting Market in Transition"; this study is available at www.wettmarkt.mecn.net
- "The European Union and its Impact on State-Licensed Gambling Monopolies"; this study is available at www.mecn.net/Publications/EU_Monopolies_E/EU_Monopolies_Ge/eu_monopolies_ge.html
- "Privatization of state-controlled Gambling Operators"; this study is available at www.privatisation.mecn.net

About MECN: MECN is a network of experts in the media and entertainment industry and supports its clients with detailed technical know-how and analyses regarding strategic problems.

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