

Financial Blocking – An appropriate mean to enforce the state monopoly on sports betting?

The Remote Gambling Association commissioned Hambach & Hambach to look into the issue of financial transaction blocking.

Attorneys at Law Dr. Hendrik Schöttle and Dr. Wulf Hambach

The tug of war on the future of the sports betting markets in Europe and in the USA continues. With the Internet Gambling Prohibition and Enforcement Act passed last year, the USA are trying to seal off the American market from without. According to the volition of the governments, this is now also meant to happen in several European countries such as Italy, France and Germany.

As a centerpiece of the corresponding regulations, among other things the payment flows to foreign providers of sports bets are planned to be controlled. Pursuant to Sec. 1084 (a) (2) of the Internet Gambling Prohibition and Enforcement Act, persons participating in financial transactions to foreign providers of bets are liable to criminal prosecution. In § 9 subsection 1 No. 4, the draft of the German Glücksspiel-Staatsvertrag (GlüStV – State Treaty on Gambling), provides for the supervisory authority to be able to prohibit credit institutions and financial service providers from collaborating in deposits and pay-outs to and from unauthorized (foreign) providers.

At first glance, these measures seem to be plausible, even if the primary interests behind them are financial interests of the respective state providers. Whoever controls payment flows can literally cut the foreign providers' pipeline, and re-

direct domestic capital to his own offers. However, the question arises, whether all this can be realized as neatly as it sounds in theory, from the legal and technical point of view.

Infringement upon freedom of capital and payment transfers

First of all it must be stated that a measure such as this would interfere with the fundamental freedom principles granted by European law. Any prohibition or hampering of cross-border financial transfers would be a restriction of the freedom of capital and payment transfers, provided for in Articles 56 et seq. of the EC Treaty.

According to permanent jurisdiction by the European Court of Justice (ECJ), restrictions of the freedom of capital transfer are admissible only for "purposes in the general interest"¹. The Court decided that in case of a restriction of the freedom of capital transfer "a justification based on general financial interests of the Member State is not admissible"². The requirements for a justification are similar in the end to the other fundamental freedom principles, such as the freedom of services. In other words: If fiscal interests cannot even justify the exclusion of foreign providers from national markets, this will even less be able to be used as a justification for a control of payment flows. As the measures discussed here in the end are aimed at securing the state monopolies in the area of gambling, the criteria developed by the ECJ in the "Gambelli" judgment apply in this case:

Restrictions on gaming activities may be justified by imperative requirements in the general interest, such as consumer protection and the prevention of both fraud and incitement to squander on gaming; however, restrictions based on such grounds and on the need to preserve public order must also be suitable for achieving those objectives, inasmuch as they must serve to limit betting activities in a consistent

and systematic manner.

In so far as the authorities of a Member State incite and encourage consumers to participate in lotteries, games of chance or betting [...], the authorities of that State cannot invoke public order concerns [...] in order to justify measures such as those at issue in the main proceedings.³

In view of the numerous exceptions in favor of the providers provided by the draft of the German State Treaty on Gambling, while at the same time the competition from other EU countries is meant to be pushed out of the market, the measures for the control of payment flows therefore infringe upon the freedom of capital transfer.⁴

The EU commission's position on the German State Treaty on Gambling is unambiguous. The Commissioner for the Internal Market, McCreevy, said in October 2006 that he would not accept the plans by the heads of the Federal States for the preservation of the monopoly:

Even the restrictive regulations for providers of gambling valid in Germany at present are considered by the EU Commission as not being admissible. [...] Now, the Federal States intend to strengthen and extend these restrictions. This is by no means possible.⁵

The acting President of the Commission, Barroso, also joined this opinion.⁶ He said that the infringement proceedings already initiated would be fought through to the last instance, if necessary. After all, the same rules must apply for private and for state providers.

Actual enforceability

The non-compliance with European law of provisions of criminal

law and of cease-and-desist orders with the objective of controlling cross-border financial transfers is one thing. Another thing is the actual enforceability of such controls.

Looking closer for instance at credit card payments, a supervision of payment flows really seems to be within the framework of what is possible: payments by credit card are processed in an encoded fashion. According to the credit card institutions' contract terms, the contracting companies undertake in the acquisition contract to mark their transactions with a so-called Merchant Category Code (MCC). MCC code 7995 for instance stands for the category "Betting (including Lottery Tickets), Casino Gaming Chips, Off-Track Betting and Wagers".⁷ This means that in principle it would be possible for the companies participating in financial transactions – even if this is linked with considerable effort – to not process any payment transactions market with MCC 7995.

As easy as this procedure seems to be in theory, as complex it is in practice. If the only filter applied would be MCC categories, credit card payments to state providers or procurers of state-provided offers would suddenly not be possible any more either. This can hardly be the state's intention. In addition to this, by no means all payment transactions which are, for instance, stakes for sports bets, are also marked as such. Many online companies not only offer payment by credit card, but also cooperate with so-called e-wallet services, such as Neteller, PayPal or T-Pay. Those providers have become more and more popular in recent years and are now being used by many online platforms, for instance on eBay. It cannot be seen from an MCC coding of payments transferred to or from such companies, what type of use they are earmarked for. Almost no e-wallet provider cooperates exclusively with sports betting providers. This means that whoever intends to cut off the alternative route via e-wallet providers, would have to entirely exclude these providers from

the trade. However, this would mean that at one fell swoop all payment transactions of uninvolved parties would be affected, such as processing of purchase price payments on eBay.

The recent consequences of such measures can now be seen on the US American market: After the reputable domestic e-wallet providers withdrew from the market, foreign hardly regulated providers now are conquering the territory step by step. M. Millerwise, director of public affairs at the US Treasury, gets to the crux of the matter: "When such service providers are located in the U.S., they are subject to both state and federal controls." However, providers from overseas will not be subject to US laws nor can they be controlled. Therefore, the system can now be abused more easily for purposes of money laundering or for terrorist financing.⁸ In Europe as well, it will probably only be a matter of time until this exchange of payment providers takes effect.

Control of financial flows is furthermore complicated by credit cards and e-wallet payments not being the only payment methods provided on the internet. In addition to bank transfers and direct debits which are usual in Germany, in the US the predominant method is payment by check. Unlike credit card payments, these payment routes are not encoded. It would mean an administrative effort that could by no means be handled by the banks, if they had to examine each individual payment. The Independent Community Bankers of America pointed out in a letter to the US Senate in 2006 that in 2004 approx. 12 billion bank transfers were processed through them in the USA and that approx. 36 billion checks had been cashed. As it is impossible to check each individual one of these, the threat of criminal prosecution posed by the Internet Gambling Prohibition and Enforcement Act results in an unacceptable risk for the banks involved and for their employees.⁹ The situation in Europe does not differ from this. Here, as well, the banks would not be able to examine all payments.

Jean Bergevin, head of the EU Directorate General "Internal Market and Services" therefore reached the conclusion during the conference "The Future of Gambling in the Internal Market" on 15th February 2007 in Trier, that the measures provided, for instance by the German State Treaty on Gambling, infringe upon the principle of proportionality.

Conclusion

Also the most recent attempts by the Member States to control cross-border financial transactions are induced by a motivation which cannot justify the restriction of the freedom of capital and payment transfers within the EU. Furthermore, the execution of such controls would present a disproportionate burden for uninvolved banks and other providers of payment services on the Internet. In the end, controls in the areas of bank transfers and direct debits already will fail due to the gigantic number of data and transactions which would have to be examined. Finally, should the providers present in the European market today, such as PayPal or Neteller, be squeezed out, this would leave a gap which will probably be filled quickly by dubious providers who will be far more difficult to control.

(1) EuGH, judgment of 3rd February 1993, case No. C-148/91, „Veronica“, paragraph 10.

(2) EuGH, judgment of 4th June 2002, case No. C-367/98, paragraph 52.

(3) Judgment by the ECJ of 6th November 2003, paragraph 67, 69.

(4) This has recently been confirmed in a legal expertise by Professor Dr. Rupert Scholz and Professor Dr. Clemens Weidemann, see legal expertise by Lawyers Gleiss Lutz dated 16th February 2007, p. 163, available at www.bundesliga.de/media/native/dfl/dfl-statuten_und_regeln/gutachtenwetten070216.pdf

(5) Compare interview with Charlie McCreevy in the magazine Spiegel, issue 43/2006 dated 23rd October 2006, p. 90

(6) See newspaper taz dated 8th December 2006, „EU schneller als Monopolisten“ (“EU faster than monopolists”).

(7) A complete overview can be found under www.mrsc.org/GovDocs/P58mcc_codes.pdf.

(8) Quoted from Catherine Holahan, “Online Gambling Goes Underground“, BusinessWeek Online of 19th October 2006.

(9) Letter by Independent Community Bankers of America dated 28th July 2006, available at www.icba.org/files/ICBASites/PDFs/ltr072806.pdf.