

Social Networks, Social Games and Gambling Monetizing the German market – top or flop?

By Dr. Stefan Bolay and Axel Knabe, Hambach & Hambach Law Firm

Online operators move ahead in their attempt to monetize the vast customer base that has coalesced around the social web in recent years. Social games and online gambling promise to be ideal candidates for creating additional revenue, not least for social networks. In Germany, however, arguably Europe's most important market in this regard, many such business models seem destined to fail due to a rather hostile regulatory landscape. Yet that is only half the truth: The time to enter the German market is now, as it presents market players with unique opportunities.

A market on the move, with Germany on the sidelines

At this very moment, a rather curious development is taking place in the European gaming market. Social networks and social games operators are constantly pushing the envelope in terms of monetizing their customer base. King, which recently surpassed Zynga as the number one app developer measured in monthly active users on Facebook has begun to shift its revenue model from in-game advertising to in-app purchases as well as microtransactions. At the same time Zynga continued its push into real money gaming products with its launch of Zynga Plus Poker and Zynga Plus Casino in the United Kingdom in April of this year. By the end of July Zynga announced to reduce its ambitions in the US gaming market and to stick to free-to-play gaming models. Facebook's last quarterly earnings report revealed a significant boost in its advertising revenue on mobile devices, which for now helped assuage worries that the company could not cope with the ongoing migration from

desktop PCs to mobile Internet usage. This was though accompanied by new reservations that those revenue streams might tie the company down in an “advertising revenue bubble” bound to burst once the app market has matured further. Taken together with persistent concerns over the right balance between user satisfaction and exposure to ads on their platform, social networks still thirst for additional revenue sources, including gaming. The markets are volatile. The search for new or improved monetization models is palpable. Beneath all this, a billion dollar question lingers in the European gaming market. What is the state of play in Germany?

Regulation by the German states, effective at the federal level due to an Interstate Treaty on Gambling, largely prohibits online gambling. Certain exceptions apply to online lotteries and sports betting. The latter is restricted to a stringent licensing regime that allows only 20 licenses to be granted by authorities. Until recently one of the states, Schleswig-Holstein, had gone rogue with a separate Gambling Act that allowed for unlimited licensing of online-casinos and online sports betting. Almost fifty licenses had already been granted when a new majority in the state legislature overturned the Gambling Act and joined the Interstate Treaty on Gambling. For now, the prohibition on online gambling is, in theory, in effect in all 16 states. Yet operators that had already obtained a license in Schleswig-Holstein can nonetheless offer online gambling based on the license conditions and operators like bwin, mybet or onlinecasino-deutschland are advertising their gambling sites nationwide on TV (e.g. Eurosport), in newspapers (e.g. BILD) or online (e.g. Spiegel-online.de).

This regulatory and market snapshot explains why Germany’s gaming market mostly attracts attention for being messy, which bears risks but also promising opportunities.

Beyond the obvious, market opportunities abound

Social networks as well as gaming operators can help define the outer limits of Germany's still nascent overall gaming ecosystem in the years to come. Developing the building blocks of such an ecosystem within the staples of current regulation can help lay the groundwork for a lasting market presence and influence how the regulatory system will develop over time. From a legal standpoint, three major strategic questions need careful consideration.

Is there a regulated market for online-gambling in Germany?

Yes, there is. Under German law, any online game in which participants pay to play for money or prizes of monetary value with a predominant element of chance dictating the outcome is considered a gambling offering. The current Interstate Treaty prohibits online gambling except for the 20 federal licensees who can offer online sports betting. There are, however, over 20 licensees that are allowed to offer online-casino games under the rules of Schleswig-Holstein's Gambling Act until at least 2019, among them bwin, PokerStars and Merkur Interactive. Advertising those offerings throughout Germany might become another point of contention. For now, it is plausible to consider such advertising – from the EU law perspective – to be legal. Germany's big media companies such as Axel Springer or Constantin Media seem to share this assessment.

All of this warrants the conclusion that there exists a nascent yet adequate market for real money gambling in Germany. In the years to come, Schleswig-Holstein should be a testing ground for licensed operators and social networks to build an ecosystem of responsible gaming, one that could be at a later stage expanded to the federal level. A failure to seize this opportunity would probably diminish a considerable tendency among lawmakers across Germany to liberalize the online gambling market. One would certainly be mistaken to read Schleswig-Holstein's recent accession to the Interstate Treaty as a definitive signal against liberalization.

Could social games operators' monetization efforts face overregulation in Germany? What about data protection regulations?

Compliance challenges could certainly increase over time and in light of different monetization models yet would be manageable with a carefully tailored legal strategy. For now, social games that rely on „freemium models“ for monetization do not face any acute danger to evoke regulatory authority under the Interstate Treaty. Usually, those games either rely on participants' skills rather than chance (e.g. gameduell.de) or they are free to play (e.g. FarmVille (2) or fulltiltpoker.de). Therefore, they do not require a gaming license under German law. This does not mean, however, that regulators do not keep a close eye on how social games' monetization efforts might evolve over time. Certainly the competent German media supervision authorities should be “informed” about these license-free offers.

Aside from that, it is at least as important to consider the full spectrum of potentially applicable regulation. King's new emphasis on in-app purchases is one recent example. As social games operators' monetization models evolve, a constant reassessment of applicable regulation is a pivotal requirement for a successful market operation. The fluidity and variations of monetization efforts invoke different legal challenges. In-app purchases may not be relevant from the standpoint of gambling regulation yet they certainly warrant a closer look with regard to consumer protection laws. Youth and player protection in general might well become a focal point for regulators the more social games emphasize microtransactions to boost revenue. In Germany, the „average consumer doctrine“ can entail significant challenges for microtransaction schemes, which is why they should be subjected to a „baseline test“ to corroborate their compliance with an average consumer's rights pursuant to applicable laws.

Obviously, **data protection regulation** is and will remain a

constant companion, especially with recent lower court decisions in Berlin and Frankfurt turning up the heat on Apple's as well as Samsung's terms and conditions of their app stores. This will affect the gaming industry at least as much as any other area of the digital economy. To date, one of the most underestimated future pitfalls from a data protection standpoint concerns the so called constitutional right to integrity and confidentiality of information technology systems. Its fancy name as well as its basis in German constitutional law should not fool anyone. This right might have serious and far-reaching consequences for the scope and substance of data protection obligations, from the depth of data security standards to the legality of automated software updates. As for the latter, the "Samsung decision" of the District Court Frankfurt offers a snapshot of what might lie ahead, holding a clause concerning such updates to be illegal for, amongst others, insufficiently covering the extent to which a customer's software could be altered. While adoption of the proposed European Data Protection Regulation would also mean that the European Court of Justice replaces national constitutional courts as the final arbiter in most matters concerning the privacy of personal data, German constitutional doctrine could still significantly sway data protection standards. At first, all of this certainly feels like a rather academic question. It is not. In fact, it is about time to consider the practical implications this might have for data protection compliance.

Is "social gambling" under threat from regulation in Germany?

No, because there is no such thing as "social gambling". Admittedly, in recent discussions concerning gaming regulation one sometimes stumbles upon this concept. It seems as if the term was coined to describe some kind of „hybrid“ between social gaming and gambling. However, for the German market at least, „social gambling“ is a description for something that simply does not exist as a matter of regulatory compliance.

All it does is diluting an otherwise clear-cut distinction between two opposite poles. Social games may involve monetization models that put them over the definitional threshold of the Interstate Treaty on Gambling at which point they simply become gambling offerings. There is not – and probably will not be – some sort of legal no man's land in which certain games elude a specific enough regulatory classification. It is either one or the other. Therefore, maybe not as a description of a certain business model yet as a matter of legal compliance, it is advisable to eliminate „social gambling“ from one's vocabulary.

There is no need for it anyway. A reasonable and economically feasible compliance program, especially at the moment of market entry, requires clear structuring and classification of prospective regulatory obligations. There is no upside in vagueness as it only facilitates short-sided and potentially ill-advised tactical and strategic decisions. Once again, Germany's „regulatory jungle“ could be more useful than one might think. For social networks, partnering with licensees in Schleswig-Holstein is an ideal opportunity to test-run both social gaming as well as gambling operations in a stable regulatory environment. It can also help identifying the outer limits of social gaming offerings that do not amount to gambling. Later migration of gambling operations to the federal level might be much easier as they would have already been embedded in a sophisticated compliance architecture. For Schleswig-Holstein's Gambling Act might come relatively close to what lawmakers would adopt in the whole of Germany at a later stage.

It's time: Designing a „beta-version“ of Germany's future gaming ecosystem

There is a window of opportunity for social networks and games operators to tap more forcefully into the German gaming market. There might not come another one quite like it. Only time will tell what market players make of this moment and how

it will influence Germany's ongoing legal and political struggle for further liberalization. One thing is clear: Missing out on this opportunity could prove to be a serious mistake. Schleswig-Holstein can, and should be, a testing ground for licensed operators and social networks alike: Which kind of responsible gaming ecosystem can be developed and how could it combine elements of gambling and social gaming? Consider it the legal equivalent of a „beta-version“, a trial and error phase for the federal gaming ecosystem that is to be built in a future liberalized market.

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