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Gaming/Global - Europe Practice | Alert

August 2016

Brexit: Implications for the Gaming Industry

This note addresses the impact of Brexit on the gaming industry. It is one of a series of GTM Alerts designed to assist businesses in identifying the legal issues to consider and address in response to the UK's referendum vote of 23 June 2016 to withdraw from the European Union. In particular, it considers the impact that Brexit might have on gaming companies located in the UK and Gibraltar. Gibraltar is a self-governing British overseas territory which joined the EU in 1973 at the same time as the UK as part of the UK rather than as a separate Member State. As a result, if the UK leaves the EU, then so too must Gibraltar.

Timing of Brexit

The UK, including Gibraltar, has not left the EU. It will remain a member of the EU, and EU law will continue to apply in the territories of the UK and Gibraltar for some time.

Before exiting, the UK needs to go through the exit procedure set out in Article 50 of the Treaty on European Union, starting with notification to the European Council of its decision to leave the EU. The new UK Prime Minister, Theresa May, appointed on 13 July 2016, has clearly stated that, while "Brexit means Brexit", there should be no rush to serve the Article 50 notification. She and David Davis, the Secretary of State for the new government department in charge of managing Brexit, have supported the view that notification should not take place before the end of the year. Following their recent discussions with Mrs May, German Chancellor Angela Merkel and French President François Hollande have both accepted that the UK needs time to prepare for exit negotiations, although they have also stressed that the UK's Article 50 notification should not be unduly delayed as this would not be in the interests of the EU or UK economies.

While the situation remains fluid, it is expected that the next few months will see the UK establishing its preferred negotiating position on the terms of its exit from the EU and its preferred model for its future relationship with the EU,

with notification possibly occurring in early 2017. When the notification is made, it will trigger a two-year, extendible period of negotiation with the EU on the UK and Gibraltar's terms of exit only. For more information on the timeline for Brexit please see our previous *GTM Alerts*, "Brexit: The Timeline" and "Brexit: Progress Report One Month in".

At this time, it is not clear if negotiation of new arrangements with the EU will be conducted in parallel, or at a later stage. It is, however, clear that the UK intends to start discussing trade terms with non-EU countries as soon as possible.

In the next few months, Gibraltar is likely to be considering its options and liaising with the UK government in order to ensure that its interests are suitably protected. There have so far been no official statements regarding Gibraltar's position and we are monitoring developments in this area.

Economic Significance of Gaming Sector for the EU, the UK, and Gibraltar

The total estimated size of the gaming market in the EU in 2015 was around €85bn. Of this, around €13bn relates to online gaming, of which the UK accounts for approximately €3.5bn.

Over the last 10-15 years, Gibraltar has established itself as an online gaming hub and is home to around 30 licensed B2B and B2C gaming companies. It is estimated that the gaming sector accounts for 20-25 percent of Gibraltar's GDP. Around 3,000 people are directly employed by gaming operators in Gibraltar and approximately 1,000 jobs indirectly rely on the industry. Many of these jobs are carried out by some of the 10,000 or so individuals who currently commute into Gibraltar from Spain on a daily basis, benefiting from their rights of freedom of movement as EU citizens.

Gibraltar's popularity amongst online gaming providers is undoubtedly linked to its approach to taxation. In Gibraltar, fixed-odds betting operations are taxed at 1 percent of turnover up to £42.5m of annual turnover, with tax capped at a maximum of £425,000 and a minimum of £85,000 per annum. Internet casino gaming tax is levied at 1 percent of gaming yield or gross profit and is subject to the same caps.

Current Legal Framework for Gaming in the EU – a National Patchwork Quilt

The provision of gaming services is one of the few areas of economic activity with cross-border potential that has not been the subject of harmonized legislation within the EU. This is true both for traditional forms of bricks and mortar gaming, such as casinos and betting shops, and for the growing market for online forms of gaming, including poker and casino-style games.

Instead, each EU Member State retains the discretion to develop its own regulatory framework which ensures that the social and cultural factors specific to each Member State are adequately protected. The EU recognises that those factors may differ between Member States, as may the approach to any common factors.

Some EU Member States prohibit the offering of any games of chance on the internet. Others have established monopolistic regimes licensing a single provider of these services. A growing number have set up open licensing systems allowing more than one operator to offer services on the market. In recent years, national regimes applicable to online gambling have undergone reform in order to keep pace with technological advancements and the development of the sector. Licensing regimes regulating gaming operators at the point of consumption have been introduced in a number of Member States, including the UK.

This means that unlike the financial services sector, where national licences are effectively 'passported' into all other EU Member States, there is no system of mutual recognition of licences within the EU gaming sector. An operator that is licensed in one EU Member State will not automatically be permitted to provide the same services in other EU Member States. Instead, operators may be required to obtain multiple licences in different EU Member States.

Challenges to Restrictive National Rules – Asserting EU Rights

The discretion to develop national legal frameworks is not, however, unfettered.

The EU Court of Justice (**CJEU**) has confirmed that the provision of cross-border gambling offerings is an economic activity that falls within the scope of the four fundamental freedoms of the Treaty on the Functioning of the EU (**TFEU**). Article 49 TFEU protects the freedom of businesses established in EU Member States to establish operations in other EU Member States and Article 56 TFEU protects the freedom to provide cross-border services.

Limits on these freedoms may, however, be permitted on grounds of public morality, public policy, public security, or public health, provided that they are legitimate. Legitimate public policy objectives justifying restrictions on gaming activities include protecting consumers, addressing problem gambling (*e.g.*, addiction and overspending), and tackling fraud, money laundering, and other crime. The restrictions, however, must not only pursue a legitimate objective, but must also be suitable for tackling that objective, proportionate to the level of the risk, and must be applied in a consistent and non-discriminatory way.

Gaming companies have challenged national restrictions by asserting their TFEU rights. Complaints to the European Commission have launched infringement cases against various Member States, including Finland, Greece, Hungary, the Netherlands, and Sweden. Gaming equipment manufacturers have also been able to challenge restrictions on importing machines and other gaming equipment between Member States.

Whilst some of these restrictions have been found to be in breach of the TFEU obligations, others have been found to be legitimate. The latter category includes, for example, restrictions that require an entity to be established in a Member State of the European Economic Area (**EEA**) or the EU before it can apply for a licence. Similarly, restrictions that require the technical infrastructure, hardware, and software to be located in an EEA/EU Member State have also been deemed acceptable.

Online operators licensed in locations such as Gibraltar or Malta have felt confident, therefore, in taking the approach of operating in certain Member States with restrictive regimes and, if challenged, defending any action by local regulators with reference to this 'EU defence' and to the licences that have been granted in another EU Member State.

Potential Consequences of Brexit for Gaming Companies Located in the UK and Gibraltar

Post-Brexit, and depending on the model chosen for the UK and Gibraltar's future relationship with the EU, the protections outlined above may no longer apply to operators based solely in the UK or Gibraltar.

There is a range of options for this future relationship. One option is to join the EEA. Gaming companies located in a country that is an EEA Member State are entitled to assert and rely upon rights of establishment and to provide services within the EEA. This includes, for example, the ability to pursue challenges against Member States' regimes that are not deemed to be TFEU-compliant. Under any other model, those rights would not be guaranteed and the 'EU defence' approach to operating in 'grey' markets might fall away for the relevant companies. In addition, they may encounter issues when applying for national licences, as the rules in some Member States require companies to be based in another EU or EEA Member State in order to apply for a licence.

For bricks and mortar operators focused primarily on the British market, this is unlikely to be seen as an issue. For non-UK companies wanting to participate in the UK's online gambling market, not much is likely to change either – a UK licence will still be required post-Brexit as it is currently. For UK and Gibraltar registered entities wishing to operate in the remaining EEA and EU Member States, however, there could be a change as they may need to reconsider their strategy to ensure that they have an ongoing EEA presence.

In addition to gaming specific considerations, other aspects of EU legislation that govern general commercial conduct are relevant to gaming companies based in the UK and Gibraltar. This includes, for example, rules relating to data protection, data privacy and electronic communications, cyber-crime, employment, unfair commercial practices and unfair contract terms, distance selling, and consumer rights. Issues relating to tax treatment and VAT will also be important factors to be taken into account. Any aspect of UK law that is derived from EU law may be subject to change as a result of Brexit. For a more detailed consideration of these issues, please see our subject-specific Alerts here.

Ability to Challenge Restrictive National Rules Under the WTO Arrangements

As explained in a previous *GTM Alert*, the UK may need to look to its rights as a member of the World Trade Organization (**WTO**) in relation to market access and non-discrimination as a way of regulating its relationship with the remaining EU Member States post-Brexit, particularly if there is a transitional period between leaving the EU and entering into new trading arrangements.

One of the agreements forming an integral part of WTO law is the General Agreement on Trade in Services 1995 (**GATS**), the purpose of which is to achieve greater liberalisation of trade in services and dismantle barriers for cross-border service provision. GATS contains two key obligations – the most-favoured-nation (**MFN**) treatment obligation which looks to ensure equality of opportunity for all WTO Members to supply like services, and the national treatment obligation prohibiting a country from discriminating against other countries. The national treatment obligation applies only to the extent that a Member has provided market access commitments for each specific service sector. Commitments relating to gaming services fall within Sector 10D - recreational, cultural, and sports services. GATS also recognises the right of WTO Members to regulate services in their territories in order to meet national public policy objectives. This includes imposing restrictions that are necessary, proportionate, and non-discriminatory.

In 2003, Antigua brought a successful challenge against U.S. measures that prohibited the supply of online gaming services, with the WTO's Appellate Body concluding that this was a market access barrier that breached the United States' full market access commitment in the area of recreational, cultural, and sports services. Ultimately, the United States decided to withdraw that market access commitment and pay a compensatory award to Antigua.

Despite this decision, however, WTO rights may not be a straightforward substitute for the ability to exert EU rights in the context of online gaming operations in the EU. The scope of the WTO rights and the applicable regulatory framework is complex and may not offer companies an effective route for defending their ability to operate in EEA Member States with restrictive regimes. Any potential challenges would need to be considered on a case-by-case basis.

Impact on Other Initiatives for Cooperation

Despite the lack of EU Single Market harmonisation of regulation for gaming, there have been EU-led initiatives to achieve greater cooperation and, where possible, some standardisation in this area. This includes the European Commission's recommendations for greater coordination in its 2012 communication "*Towards a comprehensive European framework for online gambling*", and the November 2015 agreement between the gambling regulatory authorities of the EEA Member States to enhance administrative cooperation. The agreement covers the organization of gaming and administrative procedures, consumer protection, crime prevention, and practical cooperation to assist the authorities in their day-to-day supervisory functions, including the sharing of information and best practice.

As it is not underpinned by any EU legislation, the 2015 agreement is voluntary and non-binding. Whilst it is currently limited to gaming authorities in EEA Member States, it is certainly feasible that it could be adapted so as to enable participation by the UK's Gambling Commission and Gibraltar's Gambling Commissioner post-Brexit, whatever form the UK's new arrangements with the EU take.

Also in November 2015, the International Association of Gaming Regulators (**IAGR**) announced a pilot scheme known as the multijurisdictional testing framework (**MJTF**), with the goal of streamlining external gambling product testing processes. Currently, the membership comprises only the UK's Gambling Commission and the gambling regulators in Alderney, the Isle of Man, and Denmark. Phase one of the scheme is limited to the operations of external testing laboratories and the testing of random number generators, with game fairness testing, field product certification, and information security following in phase two. IAGR is an international organization not related to the EU, so the UK's participation in these initiatives is unlikely to be diminished as a result of Brexit.

Will Brexit Change the UK's Approach to Anti-Money Laundering?

An important issue for the sector is the effective application of anti-fraud and anti-money laundering (**AML**) mechanisms which takes place at the level of the national authorities and individual operators.

The EU's Fourth Money Laundering Directive (**MLD4**) is due to come into force in June 2017 and will cover all gaming industry operations within the EU, subject to potential exemptions under its risk based approach. MLD4 enhances the requirements for due diligence, widens the scope of the definition of politically exposed persons, and introduces a three tier risk assessment approach. These are anticipated to have significant effects on internal measures of compliance and external enforcement activity.

Given that the UK is very likely to still be part of the EU in 2017, MLD4 will likely come into force in the UK as planned. Looking beyond Brexit, it is unlikely that the UK's approach to AML will diverge dramatically from that adopted by the EU. MLD4 stems from the latest recommendations of the Financial Action Task Force (**FATF**), a non EU intergovernmental body that develops and promotes policies to combat money laundering and terrorist financing. The UK is a member of FATF in its own right, as are the European Commission and each of the other EU Member States, and so must abide by FATF's requirements regardless of Brexit.

Strategic Options for Gaming Companies in Light of Brexit

It is inevitable that Brexit will have some impact on gaming companies operating in the EU, and consideration and ongoing monitoring of this issue should be factored into their business plans. Companies should consider the basis on which they operate in their current markets – is their licensing strategy sufficiently robust to withstand the potential effects of Brexit in the event that the UK and Gibraltar no longer form part of the EEA? Whilst this should be placed on the standing agenda for discussion and planning/risk committee meetings, any definitive action is likely to need to wait until the UK's preferred model for its post-Brexit relationship with the EU is made clear, possibly in early 2017.

The future status of the UK and Gibraltar vis-à-vis the EU is the subject of intense discussion, but it is too early to predict what type of trade arrangements they will ultimately enter into with the EU. The status of Gibraltar, in particular, is relatively unique and its authorities will certainly be pushing for a solution which enables it to retain its place in the gaming industry, which is such a substantial contributor to the Gibraltan economy. The Gibraltar Minister of Financial Services and Gaming has indicated that Gibraltar is committed to supporting the functions of gaming operations and that it is "business as usual" for the time being. The ongoing review of the Gibraltan Gambling Act will be expanded to take account of changes to the regulatory, licensing, and tax regimes that may be required as a result of Brexit and changes to Gibraltar's status relative to the remainder of the EEA.

Most commentators agree that Brexit will not be quick and that it will take at least two years once the Article 50 notice has been served, which is likely to be a sufficient cushion to allow companies to plan before taking concrete actions, but this cannot be guaranteed. The political situation remains fluid, and it is not out of the question that Brexit could occur earlier. However, in that event, a Gibraltan company might decide, for example, to establish another EEA entity and opt for Malta as the most suitable location - the Maltese Gaming Authority indicates that it only takes 12-16 weeks to obtain a licence in Malta once all the necessary information has been submitted.

In the meantime, those companies affected by these changes may want to ensure that their voice is heard amongst the many lobbyists that will be looking to influence the Brexit negotiations. If they have specific views on how Brexit should be managed, and what protections or rights are essential components of the UK and Gibraltar's future trading relationship with the EU, those views should be conveyed to the Brexit negotiating teams, whether through trade associations or independent representation.

Conclusion

The full implications of the UK's withdrawal from the EU are still being worked through and they will depend to a great extent on the model chosen by the UK for its future relationship with the EU and the actual terms of the UK's exit arrangements. Those choices will be heavily influenced by the new UK Prime Minister, but also heavily negotiated by the EU. Until there is greater clarity and certainty, businesses should continue to monitor developments, identify those areas where their businesses are likely to be affected by new or amended legislation and regulation – and, importantly, those areas that are unlikely to be affected – and determine how to mitigate risks in affected areas, but await greater clarification before acting.

Further information about issues relating to Brexit can be found here.

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