



## Andreas Kötter

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# Mobilizing State Lotteries to Defend the Interests of their Stakeholders

### PGRI Introduction:

*Andreas Kötter delivered the keynote presentation, How to protect against illegal iLotteries, at PGRI SMART-Tech conference in Fort Lauderdale, Florida. Go to PGRItalks.com to see the video-recording of this talk to get the full understanding for how illegal iLottery operators got their start, how they captured millions of customers operating illegally before now attempting to convert this customer base over to the legally licensed and regulated sector. We met at the EL Congress Antwerp to discuss how the distributional landscape is changing faster than regulators can keep up with, how the traditional state lottery operator can adapt, and the once and future impact of illegal iLottery operators.*

**Paul Jason:** Why has it been such a challenge to create a regulatory framework in Germany that meets the requirements of the EU and German federal laws? Shouldn't all EU member states have the authority to determine regulatory policy?

**Andreas Kötter:** The trends towards liberalization create complications for regulators and challenges for state authorized lotteries which rely on enforcement of laws that protect the consumer and the stability of the market-place. The games-of-chance market-place is being disrupted by a wide variety of factors. Consumer shopping behaviour and player tastes and preferences are changing as new games and options for how and where to play are proliferating across the globe and across jurisdictional boundaries. There is genuine innovation to the games and channels of distribution. And there are the illegal operators who steal IP and brand-marks and call their actions "innovation." Rules and even definitions need to be updated to address issues that did not even

exist ten years ago. Without modernizing gambling regulation nationally as well as intensifying the exchange between regulators internationally, the different legislative bodies will continue establishing rules for their own jurisdiction that may not be helpful cross-border.

One of the foundational principles of the European Union is that all EU member states agree to a system of free-markets and open cross-border competition. For that reason, German and EU law in principle prohibit restraint of trade and monopoly practices. Because of the ancillary public policy objective of minimizing social costs and harm to the consumer, an exception to this rule was made for gambling amongst others, allowing member states to determine their own regulatory policy for gambling and lottery. But there are constraints to how this exception may be applied. Monopolistic practices must serve the interests of society, protect the consumer and preserve Public Order, and not be used as a means to channel economic benefit to a particular group,

even if that group is a worthy charitable cause. We must demonstrate that the application of monopoly practices to lottery gaming is necessary to protect the health and well-being of the consumer by reducing addiction and harmful behaviours.

**How have regulations been modified to allow for the operation of Social Welfare (also called "Society") lotteries?**

**A. Kötter:** WestLotto as well as the fifteen other lottery operators in Germany, are the exclusive operators within the borders of their own federal state-jurisdiction of large jackpot lotteries that may exceed € 2 million. The regulator decided that the games with larger jackpots should be operated only by the state operator to ensure integrity and minimize problem gaming. In contrast to this, Social Welfare lotteries are granted license to operate the lower jackpot games that must not exceed € 2 millions as long as they contribute to good causes and comply with other restrictions, including a fixed percentage of revenues that can be paid back in prizes to the players.

**Does this system work well for the stakeholders of WestLotto?**

**A. Kötter:** Germany has a very long history with "Aktion Mensch" and "Fernsehlotterie", its two major Social Welfare lotteries, which account for more than 10% of the revenue that the state lotteries do. That may seem like a large percentage, but that is the result of many

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decades of co-existence between monopoly lotteries like WestLotto and Social Welfare lotteries which are legally licensed to offer smaller jackpot games.

**Are Social Welfare lotteries subject to the same advertising and marketing restrictions as the official state lotteries?**

Lottery in principle is less dangerous to cause addictive and harmful play from a responsible gaming perspective than most other games-of-chance categories which have more flexibility when it comes to advertising and marketing. Restricting our ability to advertise and promote Lottery just smooths a path for other games-of-chance categories to increase market-share. We respectfully submit that society is

border sales” and “illegal” and “iLottery”. We agreed on a multi-state treaty that established terms and conditions for a wide variety of games, not only lotteries. The Interstate Treaty proscribes how the games-of-chance market-place is to be regulated and is now binding because it has been signed by all sixteen heads of the states. This Treaty is in effect until 30 June 2021. **The states still have autonomy over some aspects of the regulations?**

**A. Kötter:** Yes, of course. The Interstate Treaty addresses those matters which affect all of us in similar ways, and which we are all in agreement on how they should be addressed. We are all in agreement, for instance, that the rule of law should be enforced everywhere, and that if the law requires a license to operate, then unlicensed operators should be prevented from doing business. We are all in agreement that rules placing more restrictions on advertising of lottery products than other gaming products should be changed to be more logical and aligned with the goals of protecting the consumer from harm and addictive play. On the other hand, the public policy priorities of the sixteen states differ in many ways, and the regulatory structure will differ accordingly. The Interstate Treaty allows for these differences. For instance, some states decided to authorize their state lottery to sell scratch cards online, while others did not.

**Gray market operators seem to be confused over the meaning of “illegal.”**

**A. Kötter:** First, in countries where it is illegal to operate without a license then, by definition, the operator is illegal if they do not have a license. Second, they need to be licensed to operate in every jurisdiction where they operate. Illegals want to be classified as “legal” if they operate legally in one jurisdiction, even if they operate illegally in other jurisdictions. We consider them at least to be illegal if they operate illegally anywhere, means without the locally required license.

**But what about the aspect in which illegals do not have to comply with any of it because they operate outside of the jurisdictional borders. The restrictions placed on the legal operators effectively channels consumers over to the illegals. Why is that a good policy?**



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*“It is not the government policy to support illegals. But it may be the unintended consequence of the restrictions placed on legally licensed operators. Illegals are increasing their market share because they operate with fewer advertising and marketing restrictions and pay less in taxes, enabling them to spend more on advertising.”*

**A. Kötter:** No they are not. Social Welfare lotteries are granted more freedom in advertising. For example, they are allowed to advertise the good causes they raise money for.

**Insofar as the official state operator exists solely to serve good causes and protect the consumer, can we hope that those restrictions might someday be amended to allow for some flexibility to promote the large jackpot games?**

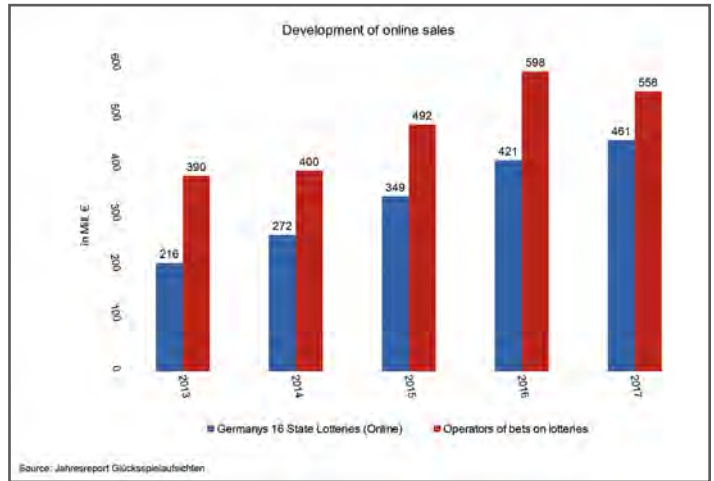
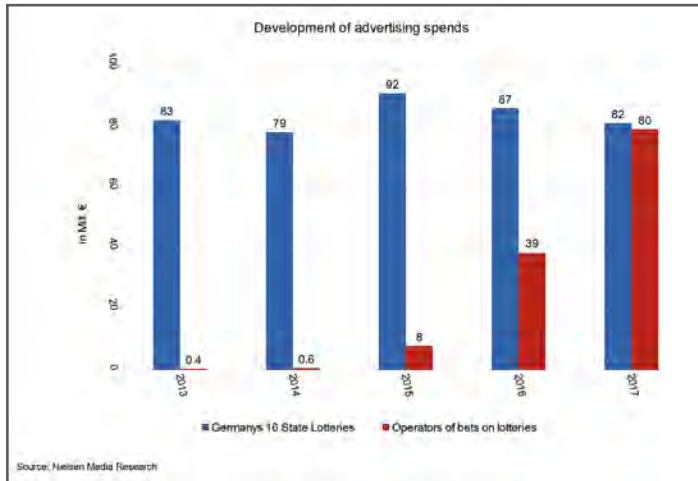
**A. Kötter:** Of course, we do hope for that, and we ask for that. We agree that

better served by channeling the consumer to less addictive or harmful games like Lottery than driving the consumer over to more harmful games. But we also respect the authority of regulators to make that decision.

**Has the intrusion of “bet-on-the-outcome-of-lottery” operators like Lottoland and Tipp 24 caused regulators to reconsider those restrictions? After all, these gray-area operators violate those advertising restrictions, hijacking revenues from legally licensed operators and the good causes they support in Germany.**

**A. Kötter:** Regulatory authority over this issue resides with each individual state, not at the federal level. The sixteen German states realize, though, that it is in everyone’s interest to work together to combat unlicensed activities like the bet-on-the-outcome-of-the-lottery model. We all realize that we need to have one agreement to get the basic rules, guidelines, and principles to be as precise and detailed as possible, and for those to be applied consistently throughout all sixteen states. There can be no ambiguities in the definitions of things like “cross-

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**A. Kötter:** Exactly. It is not the government policy to support illegals. But it may be the unintended consequence of the restrictions placed on legally licensed operators. Illegals are increasing their market share because they operate with fewer advertising and marketing restrictions and pay less in taxes, enabling them to spend more on advertising. And since their operation itself is not even legal, they might not comply with Responsible Gaming requirements that legal operators comply with. There is no requirement for them to avoid overly aggressive appeals to gamble.

**Isn't it the case that Germany is culturally and politically even more committed than most to idealistic principles of freedom of the internet as well as free-market competition? So tactics successfully applied in other jurisdictions, like IP blocking, are more difficult to get approved in Germany?**

**A. Kötter:** In addition to that, the German system of jurisprudence, our court system, adheres to rigid procedural standards that serve a very good purpose but can lengthen the time it takes to litigate a case.

**So, by the time you win in court, the illegals will have figured out a different way to evade enforcement and continue to go about their business.?**

**A. Kötter:** Or they close down their entity in Gibraltar and move to Malta. Or vice versa. Or move to a jurisdiction that has even fewer regulatory requirements and even lower taxes. It is difficult, but we are making progress, one step at a time. The

digital world has created complications when it comes to controlling cross-border commerce and advertising.

**Now, operators like Zeal Networks and Lottoland are attempting to re-shape their business model to be accepted in the legally licensed, regulated sector.**

**A. Kötter:** Tipp24, which is now a division of Zeal Networks, got its start in Germany as an online re-seller of lottery tickets. They operated legally, purchasing the lottery ticket from the authorized state operator. Then, the online selling of lottery products was changed in 2008. Tipp24 moved to London and implemented the first bet-on-the-outcome-of-the-lottery model. The millions of customers who were buying from them when they were selling the legally authorized product could see no difference in the way the product was packaged and sold and so continue to buy from them even today. Zeal Networks has now assembled a family of online companies, some of which operate with legal license and others which operate in at least some jurisdictions without proper local license. Zeal Networks now bought the biggest German reseller and announced to transfer the clients of Tipp24 back into the legal system. This is a big success for all stakeholders and may result in the conversion of millions of illegally acquired customers into legally authorized revenue streams.

Lottoland started its bet-on-lottery operation in 2013 and is still acting without a local license in the German market. We hope that our efforts will also lead them into a legal system in Germany.

**What can be done to stop illegal iLottery?**

**A. Kötter:** Currently, we have filed 45 legal actions against illegal operators. But while this is being litigated, illegal operators are spending as much on advertising to capture the online market in Germany than the state authorized lotteries spend altogether on advertising. Together, the state lotteries spend just over € 80 million to advertise all our products for all the land-based and all channels of distribution. The illegals spend the same amount but with all their resources focused on the online players. Combine that with the fact that they hardly pay taxes or contribute the same as state lotteries to good causes in the consumption country, so they can offer bonuses and other enticements to attract new players. The result is that illegal operators now have a bigger market-share of the online channel than legal operators.

And they are further leveraging their brand

*“Our concern is not so much about short-term financial impacts on the business as in the long-term sustainability of regulatory models that protect the consumer as well as the stability of the markets. It is challenging because our adversaries disrupt the market-place not with innovation but with tactics that exploit loopholes in laws and regulations.”*

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and their operating assets by developing a B2B strategy in addition to their B2C business. Of course, the increased volume further enhances their liquidity, increases cash-flow to fund prize payouts and reduce insurance costs, thereby increasing profitability and the funds to expand market-share even faster.

**You are chair of the Illegal Lotteries and Betting Committee for the World Lottery Association. What is the global outlook on illegal lotteries?**

**A. Kötter:** The problem of combatting illegal lotteries is global. It is cross-border and affects everyone everywhere. That is why the WLA has taken up the job of trying to support its members in their own efforts. The first step is to build awareness and understanding of the nature of the problem, the implications it has for traditional authorized lotteries, and the need to protect the interests of our stakeholders.

In this as in all aspects of business, we need to keep the consumer at the center of our attention. Our concern is not so much about short-term financial impacts on the business as in the long-term sustainability of regulatory models that protect the consumer as well as the stability of the markets. It is challenging because our adversaries disrupt the market-place not with innovation but with tactics that exploit loopholes in laws and regulations. The good news is that our goals are genuinely aligned with the state and the general public to defend the interests of society, protect the consumer, and support worthy causes. But the mandate to make our voices heard is more urgent than ever because there is no end to the ingenuity of illegals and their ability to find new ways to evade the laws.

**The bet-on-the-outcome-of-the-lottery is an especially egregious example of no innovation, just a theft of the Lottery's intellectual property.**

**A. Kötter:** We are the ones who are innovating and creating new products, new services, new ways to deliver more value

to the consumer. Of course we expect the rule of law to be enforced over against those who violate it, and will fight to defend our IP, the integrity of our brand, and the interests of our stakeholders. But we need to drive innovation to make sure the products we create continue to delight the players, and make them available in all the different ways, through all the channels, that the modern consumer expects. We need to hold ourselves accountable to the same metrics that measure performance as other business sectors do. For instance, if we see that only 10% of our revenues come from the online channel, we can probably know that our methods of online sales can be improved to meet a higher standard of consumer expectations.

In the end, no amount of regulatory protection can replace the need to create games that players love, make them available to play on all the new trade-styles and channels of distribution, and exceed consumer expectations in every category of performance.