

GAMING THE SYSTEM

Billions of dollars in gambling revenue flow offshore every year due to outdated gaming laws and law-enforcement agencies with limited resources BY SANDRA RUBIN

EVER PLACE A BET on the outcome of a pro-sports game or play a few hands of poker in an offshore casino from your couch? You're not alone.

It is estimated Canadians placed at least \$4-billion worth of bets last year outside the reach of provincial regulators, mainly through online poker and sports-betting sites that may be located in places like Gibraltar, the Isle of Man and Cyprus.

Is it legal? Michael Lipton, one of Canada's top gambling lawyers, believes offshore operators taking Canadian bets is not. Still, no need to worry about the police swooping in to seize your computer. Canada's gaming laws are about as antediluvian as a game of pickup lacrosse.

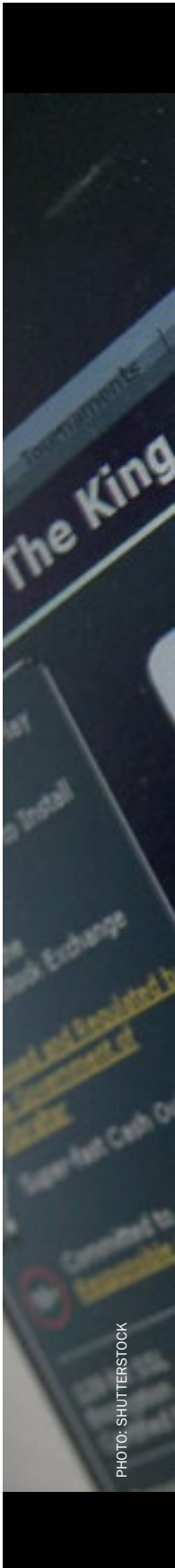
The relevant part of the *Criminal Code* that gives the provinces and territories the exclusive right "to conduct and manage" gambling doesn't even contain the word Internet. Go ahead, do a search. Part VII, s. 201.

You won't find the words "online" or "electronic" in there either. Computers? Exactly once, in the section discussing licensing lotteries. The reason is the section was last amended in 1985 — before the Internet was in common use, before people were even using email.

Things like betting on fantasy sports games that mimic traditional baseball or football leagues, betting in virtual gambling dens using virtual currency — these things were never contemplated when the Code was amended.

Yet here we are. More than 56 million Americans and Canadians bet on fantasy sports every year, according to the Fantasy Sports Trade Association, spending an average of US\$465 each.

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When it comes to regulating the new forms of gambling in the Internet era, Canadian officials aren't even bringing a knife to a gunfight. The *Criminal Code* provisions are more like a 1950s-era butter knife.

That's left the provinces watching in frustration as billions dollars a year flow offshore that was previously taxable.

While the legality of offshore gaming companies accepting Canadians' bets



MICHAEL LIPTON > DICKINSON WRIGHT LLP

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hasn't been tested in the courts, Lipton, a partner in the Toronto office of Dickinson Wright LLP, believes it is illegal. He says offshore companies that advertise here and enter into contracts to accept bets from Canadians have enough of a connection to the jurisdiction to subject them to prosecution.

"The question quickly comes down to what the provincial lottery corporations are doing about this," Lipton points out. "What are the law-enforcement agencies doing about it?"

The answer, he says, is not much.

"There have been no recent prosecutions — none whatsoever. There have only been two prosecutions ever in Canada in relation to Internet gaming and both involved servers located in Canada. One was in 2001, the other was in 2007.

"Law-enforcement officials have bigger fish to fry and they've got limited resources, and the public may also not be crying out for enforcement. There may not be any harm people are suffering. Many of the

offshore regulators are heavily regulated in their home jurisdictions, which do a very good job."

The thing is, there should be an outcry. Not related to morality, or protecting Canadians from unscrupulous operators, but over lost revenue.

According to the Canadian Gaming Association, revenues from Canadian gambling are around \$16 billion a year. With more than a quarter of that going offshore, that's a significant amount of money governments have to make up through taxation or program cuts.

"There are no taxes or revenue-sharing on online sports betting, so the profits on that \$4 billion just leave the country," says association Vice-president Paul Burns.

The large amounts may explain why the US has been so alive to clamping down on this issue. "In the United States, the American authorities have been very, very

aggressive," Lipton says. "They've done everything from arresting principals of these companies when they get off an airplane that has landed in the United States to seizing domain names and monies and laying charges against people involved in these operations, for example PokerStars and Full Tilt Poker, two large poker operators — which have now, by the way, been sold to a Canadian company.

"The result of the Americans being far more aggressive is that there are opportunities in Canada."

Ilkim Hincer, Co-chair of the Gaming Specialty Group at Osler, Hoskin & Harcourt LLP in Toronto — and a former general counsel of the British Columbia Lottery Corporation — says there's "a very real desire to deal with these new types of issues in the online space, the virtual space, in a modern way. But the only way that can happen is if the government amended the *Criminal Code*.

"Once upon a time I would have thought

that would have been impossible. But with the proliferation of Internet gaming and virtual gaming and mobile technology, this convergence of technology with gambling, who knows? I don't think you or I can pass a day without dealing with the virtual world. We have email, we have social media, we do transactions online, we order from Internet stores. It's part of the very fabric of our existence.

"But gaming laws, at the federal level, are stuck in 1985."

WHAT HAS INDUSTRY associations really fuming about Canada's gambling law is not even that it doesn't properly protect its designated gambling operators, it's that it actually disadvantages them.

The Canadian Gaming Association says offshore gaming companies are competing with a stacked deck, offering a much wider array of betting options than the provinces and territories are permitted to. And they do so with apparent impunity.

Sites such as UK-based Bet365, which advertises it has more than 19 million customers in almost 200 countries, offers not only single-game betting, it also accepts wagers on individual plays and individual players after the game has started. So does Malta-based Betway, which sells itself as having more than 30,000 "betting markets" available.

The mainstream offshore sites make mobile apps available for download in Canadian app stores.

The provinces (aside from Saskatchewan) are trying to combat the Internet gaming giants' betting by building their own Internet-betting sites. BC began offering online sports betting in 2004 and has since added poker and online casino games. Most other provinces in Western and Central Canada offer similar suites, although the Maritime provinces have mostly shied away from online casinos.

It's a David and Goliath battle.

Where Canadians spend \$4 billion plus on offshore sports betting every year, they spend about \$500 million at home on equivalent "official" products such as the Ontario Lottery and Gaming Corporation's Pro-Line Sports bets.

"The challenge is they're miles behind the private operators," says John Tuzyk, a partner at Blake, Cassels & Graydon LLP

in Toronto. “The offshore companies are much further ahead in their business model, including things like how to search out and maintain new customers, so they have a distinct advantage over the provincial lottery corporations.”

The offshore operators also have an ace in the hole: Single-game betting, something the *Criminal Code* specifically does not allow.

In Canada, people must bet on – and correctly predict the outcome of – at least two games but usually three in order to win. A click on your computer, however, and you can place a bet on this weekend’s big game.

Single-game betting is estimated to be a US\$100-billion-a-year proposition in the US, and its prohibition is probably doing more than any single thing to drive Canadians to take their credit cards offshore.

In 2011, Parliament approved a private member’s Bill to permit single-game sports betting in Canada but the Bill slowed in the Senate with opposition from pro sports teams, and died when the Parliament was dissolved for last year’s election.

The Canadian Gaming Association complained bitterly before last year’s Super Bowl that more than \$150 million in illegal wagering would take place during Super Bowl weekend. “The only people profiting from illegal sports betting are criminals and offshore operators who are not licensed and regulated to do business in Canada,” it said in a press release.

That could be about to change. Those supporting single-game betting in Canada won the lottery. Literally.

With no more than 30 private members’ Bills permitted on the House of Commons agenda at a time, who makes the cut is determined by a draw. In January, in advance of the new session of Parliament, the draw was held and Windsor West NDP MP Brian Masse’s name was picked seventh. He intends to re-introduce a Bill designed to legal-



ize single-event sports — and this time the hope is it will cross the finish line.

If Canada opens up to single-game betting, it will give the provinces a leg up in their battle against the online giants. But not everyone’s been waiting around.

SOME PROVINCES, including Ontario and British Columbia, have already started sweeping modernization programs, and many in the industry are carefully watch-

ing. Both provinces are looking to revamp their gaming sectors by contracting private companies to run their casinos and slots, which is closer to the US model.

Ontario’s transformation is being overseen by the Ontario Lottery and Gaming Corporation (OLG), a Crown agency formed in 1975 to manage gaming and lotteries. The OLG-led plan is dividing the province into geographic areas, or bundles, and each territory will have its own short list of potential

operators invited to bid.

Tuzyk says the way it works is the winner will buy the existing assets, such as casinos and slots from OLG, and then they're free within their specific zone, "subject to all sorts of restrictions and conditions, to redevelop the property or create a new property or pick a new site in some bundles. Basically they're given that zone more or less as a monopoly, ensuring a revenue stream to



JOHN TUZYK > BLAKE, CASSELS & GRAYDON LLP

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What may turn out to be problematic for potential bidders, according to several lawyers in the field, is uncertainty over OLG's ongoing role.

The OLG is not a regulator. The Alcohol and Gaming Commission of Ontario does that. It is a business corporation that generates revenue from the sale of lottery tickets and the proceeds of gaming. In announcing the modernization plan in 2012, it made it clear it will have an ongoing role "focusing on well-defined control and oversight functions."

While the bundle operators are supposed to be allowed to choose new sites on their territory, the agency has said it "will retain the right to approve the location of any new site" along with the government.

Some potential bidders say that's not sitting well with them, says Tuzyk. "Some of them say it raises business issues because the operators are the ones taking all the

financial risk. So there's a tension over the extent to which the province still exerts a lot of influence over the business."

A few private operators are talking about shying away from bidding on some Ontario bundles as a result, he says, and, if they do, "that's a concern. They say they don't mind being regulated – in fact most operators want to be regulated because they're operating in Las Vegas and Nevada and it's important for those regimes that they be well-regulated wherever they are. They're quite used to being regulated and complying with regulation as a cost of doing business. But they've made it clear there is a tension in terms of OLG's continuing involvement through the contract, and the way they see it that's absolutely an issue."

Does that suggest Ontario could be getting lower bids for some bundles, or fewer points on the revenue sharing than it could from some large and experienced casino

operators? Another lawyer, who spoke on condition he not be named, says it does. "It obviously influences the number of people who will bid and also the numbers they will bite in Ontario as opposed to a Las Vegas operation where they're really just worried about being regulated.

"In Las Vegas, they're not worried about the government telling them how to run their business."

QUÉBEC IS GOING a completely different route to address offshore competition for gaming dollars, and it promises to be interesting, says Lipton of Dickinson Wright. The province is planning to lean on the Internet providers to flip the "off" switch on gaming sites not eligible to take bets in the province.

"Québec effectively threw up its hands and said: 'We want to create a blacklist. We want to be in a position to create a blocking mechanism so anyone offshore

can be blocked from reaching into Québec and accepting Québécois' bets. And we want the Internet service providers to accept that blacklist."

The province has painted it as a revenue-enhancing measure, saying website blocking would increase government revenues by \$13.5 million in 2016-17 and \$27 million a year thereafter. It is hoping its Espacejeux, the Loto-Québec-run online gaming site, will pick up the business.

Lipton says it creates an interesting legal issue. "Can the provincial government effectively create a form of censorship in relation to offshore operators seeking to communicate with people in Québec? The question is whether that's provincial jurisdiction or is it federal jurisdiction — and is it unconstitutional?"

One thing is beyond question. Canadian Internet providers are not thrilled about the prospect, and have been quietly doing everything they can to fight it.

In the meantime, the competition for gaming dollars by Québec and others isn't coming only from offshore gaming sites. Some Aboriginal communities keep casinos and computer servers on their sovereign lands.

The Kahnawake Mohawk reserve outside Montréal, for example, has been hosting Internet gaming since 1997. "They're the second- or third-largest host in the world," Lipton says. "They operate openly, and according to their own legislation they enacted in 1997."

The Mohawks assert their right under s. 35 of the *Constitution Act, 1982*. They never signed a historic treaty surrendering rights with respect to their lands.

While the Attorney General of Canada has said the Kahnawake operation is not legal under federal gambling laws, charges have never been laid. Lipton believes it's because of potential for the kind of standoff that erupted into the Oka Crisis in 1990. He says it's going to be very interesting to see whether the province of Québec also tries to block the Mohawk online gaming sites under its new Bill.

"Clearly our courts have recognized First Nations as sovereign nations. Do they not then have the right to operate casinos, to regulate casinos? Why does the provincial government have a monopoly on doing that? I can see some interesting constitu-

tional issues arising.”

More litigation? Possibly.

THE TRUTH IS, considering a certain percentage of people remain opposed to legalized gambling, there’s been surprisingly little litigation in recent years.

Matthew Milne-Smith, a litigator at Davies Ward Phillips & Vineberg LLP in Toronto who frequently acts for OLG, says there are occasional claims filed against casinos trying to increase the standard duty of care.

One recent decision, *Paton (Estate) v. Ontario Lottery and Gaming Commission*, released by the Ontario Superior Court of Justice May 20, 2015, gives a sense the courts just don’t have a huge appetite for it.

In the *Paton* decision, two estates were defrauded by a law clerk who was handling the business. The clerk forged the husband’s name on a will in which she named herself as the executrix, sold two



ILKIM HINCER > OSLER, HOSKIN & HARCOURT LLP

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properties for \$1.5 million, and gambled about \$950,000 of it away at casinos. The law clerk had described herself to casino employees as a lawyer.

The two estates sued OLG for negligence, unjust enrichment, conversion and knowing receipt of trust funds. The suit was struck down on a motion for summary judgment, with Justice P.B. Hambly ruling it had no chance of success at trial.

“The fundamental flaw in the causes of action asserted by the plaintiffs is that they all would require gambling casinos to investigate customers who are losing money to determine the source of their funds,” he wrote. “This would put the gambling casinos out of business. If people are prepared to lose money at gambling casinos operating within the law for whatever reasons it is not for the casinos to interfere with their personal autonomy.”

The decision is being appealed but Milne-Smith, who acted for OLG, says if the decision were to be reversed it would have important ramifications for casino operators everywhere. “Finding as a matter of law – at least in a case where there’s no pleading that OLG is aware someone was a problem gambler – that there could potentially be a duty of care would really be something that has implications beyond this case. As it stands, it’s certainly made it a much more difficult environment for plaintiffs to advance claims of this nature.”

An even bigger and more fundamental question remains, one the courts have yet to wrestle with. In this day and age, what constitutes gaming?

WE ALL THINK we know what gambling is. Cards, sports, fantasy leagues. But Hincer says social media is actually promising to change the face of gambling at a faster pace than some people may appreciate. “What if Facebook started taking bets on the out-

come of a Scrabble-type game or something like that? It’s not too far from today’s reality that somebody’s going to try to figure out how to make money off these games one of these days if they haven’t already.

“So we’re going to have a bit of a challenge. If Facebook started taking bets on the outcome of a Scrabble-type game, should the *Criminal Code* provisions on betting not apply? Most people would

look at Facebook and not even think there is a gambling element to it. I’m not saying there is now, but just using them as an example of convergence and technology in our attempts to deal with gaming going forward, it’s not outside the realm of possibility to think these types of social games might morph.”

Hincer is hoping the proposed new private member’s Bill opening the door to single-game betting provokes a wider look at gambling laws in Canada and leads to a complete overhaul of the 1985 *Criminal Code* provisions that take the changing face of gambling into account.

Hincer, who was also formerly a Vice-president and General Counsel of Trilliant Canada Gaming, believes a licensing regime is the better way to go. “To the extent that these operators want to participate actively in a very clearly defined lawful Internet regime in Canada and have robust access to Canadian players – and you can certainly regulate that – it would require those companies to get licensed and registered. You could even force them to put up property for enforcement purposes, establish an office here, put back-up servers or actual servers here. Then you can regulate every aspect of Canadian players registering on those websites. From a privacy perspective, you can control what happens, dispute resolution, that kind of thing. But you have to bring them into the fold.”

In order to give foreign operators some impetus to recognize the licensing scheme, Canada might consider reciprocal-enforcement protocols with other jurisdictions and other regulators, he says, with an agreement to pull licences in all jurisdictions when an operator fails to meet the requirements in one.

“At the end of the day, Canadian consumers are going to do online shopping, they’re going to do online gaming, they’re going to stream Netflix. They’re in the online space, it’s not just unique to gaming. Should we deal with it? Absolutely 100 per cent let’s deal with it consistently and with clarity, either talks or discussions. I don’t know where those conversations are happening at the political level. But I hope so.”

Certainly, for Canadian taxpayers, there are about four billion reasons to do so. 🇨🇦

Sandra Rubin is a Toronto-based writer and strategic consultant.