

NOTICE OF DECISION OF THE NATIONAL LOTTERY COMMISSION¹

IN RELATION TO THE APPLICATION BY THE HOLDER OF THE NATIONAL LOTTERY LICENCE TO PROVIDE ANCILLARY SERVICES

Summary

1. Camelot UK Lotteries Limited ("Camelot") has made an application to the National Lottery Commission (the "Commission"), pursuant to Condition 6.3 of the third licence granted by the Commission to Camelot on 1 February 2009 (the "Licence"), for consent to undertake certain specific Ancillary Activities; namely the implementation of a proposal to offer a number of commercial services through its network of National Lottery terminals ("commercial services").
2. On 16 July 2010, the Commission made a provisional decision that it was minded to refuse to grant consent to Camelot's application to undertake commercial services on the basis of the EU/competition law concerns it raises (the "Provisional Decision", annexed to this Decision Notice). The reasons for the Provisional Decision were set out in paragraphs 23-28 of that document. The Provisional Decision was a "minded to" rather than a final decision in order to give those who were interested in the Commission's decision a final opportunity as a matter of fairness to address the points it made. Accordingly, the Commission requested further representations in relation to the Provisional Decision by 3 September 2010. Following the publication of further information as a result of requests from Camelot, and the provision of additional documentation by Camelot, this second period of consultation was extended, ultimately to 20 October 2010 (the "Second Consultation").
3. Following the end of the Second Consultation period, the Commission has decided to refuse consent to Camelot's application to undertake commercial services on the basis of serious concerns arising out of EU/competition law issues.

Background

4. The background to Camelot's application for consent to undertake commercial services is set out in paragraphs 4-10 of the Provisional Decision.

EU/competition law issues

5. As described in the Provisional Decision, the Commission has been advised that it must take account of certain EU and competition law rules in making its decision. The principal EU and competition law rules it must take into account, namely Articles 101, 102, 106 and 107 of the Treaty on the Functioning of the European Union (the "TFEU"), and the EU Treaty principles of transparency and non-discrimination arising out of procurement law, are described in paragraphs 11(i) and (ii) and 12 of the Provisional Decision.

¹ This decision sets out certain legal advice received by the Commission, provided to assist the reader to understand the matters considered by the Commission. It is not intended to waive privilege beyond the summary here provided.

Consultation on the EU/competition law issues

6. As described in paragraphs 14-18 of the Provisional Decision, the Commission conducted a consultation on the EU/competition law issues arising from Camelot's application for consent to undertake commercial services through the publication on 15 February 2010 of the Camelot Overview Documents (the "First Consultation"). The First Consultation was originally stated to be for eight weeks, but following the provision by Camelot of further information, and publication of that information by the Commission on 8 April 2010, the Commission extended the consultation by a further two weeks. Consideration of the responses to the First Consultation, and of the advice received by the Commission from its economic advisers, NERA Economic Consulting ("NERA") in the form of two reports, and its legal advisers, culminated in the Provisional Decision.
7. Following the Provisional Decision and the publication of the responses to the First Consultation, the Commission has conducted the Second Consultation. The consultation period for the Second Consultation was originally stated to be until 3 September 2010. However, in light of the publication of two economic reports produced by NERA, commissioned by the Commission, dated 29 March 2010 and 2 July 2010, and a legal opinion from Sir Francis Jacobs, commissioned by Camelot (the "Jacobs Opinion") and a document entitled "Remedies Proposal", each provided to the Commission by Camelot, the Commission extended the consultation period to 20 October 2010.
8. The Remedies Proposal stated that Camelot did not intend to, and would not, act anti-competitively, and that it did not believe consent would be contrary to EU or UK law. The Remedies Proposal contained two remedies which Camelot claimed would provide further assurance to the Commission that its consent to undertake commercial services would not lead to a violation of competition law: (i) that Camelot, by separate undertaking or condition to the Commission's consent, be subject to and comply with the relevant provisions of the Financial Transparency (EC Directive) Regulations 2009 (the "Transparency Regulations"); and (ii) that the Commission made any final consent subject to a 'fair trading condition', which would prohibit Camelot from entering into any arrangement or engage in any practice prejudicial to fair and effective competition, and require it to comply with any code or guidance or other direction, with the purpose of ensuring fair and effective competition (the "Fair Trading Condition").
9. The Commission received responses to the Second Consultation from, amongst others, Camelot, ePay Limited, Payzone (UK) Limited and PayPoint plc. All consultation responses were taken into account by the Commission and will be published on the Commission's website shortly.
10. Camelot submitted a detailed consultation response, together with a report by KPMG and the Jacobs Opinion. The principal arguments made by Camelot as to why the Provisional Decision was wrong, and why its application for consent to undertake commercial services would not breach EU and/or UK competition law (and accordingly would not lead to the UK breaching Article 106 of the TFEU and/or the Commission breaching its public law duties in the event consent was granted) can be summarised as follows:
 - That the Provisional Decision adopts the wrong legal test by stating that the Commission was minded to refuse consent on the basis of advice that granting consent gave rise to a significant risk of a breach of Article 106 TFEU when the Commission is under an obligation (derived from EU law) to grant consent to the

Camelot proposal unless *in fact* such consent would result in a breach of Article 106;

- That Article 106 TFEU is not a prohibition on diversification, and authorisation to enter new markets has never been held contrary to Article 106 TFEU;
- That there is no causal link between Camelot's future commercial conduct and any grant of consent by the Commission to Camelot's application;
- That Camelot's advantages are not through assets which were conferred on it by the State or otherwise protected by the State, but are business assets purchased at arms length on commercial terms;
- That there is no evidential basis for the conclusion that Camelot benefits from a material commercial advantage;
- Camelot challenged the assertion that it enjoyed advantages arising out of the use by retailers of a single terminal for lottery and payment services (arguing that retailers would need to obtain additional equipment to provide commercial services, similar or identical to that provided by existing operators) or arising out of the leveraging of the National Lottery brand;
- That there is no effect on trade between Member States and the application for consent to undertake commercial services therefore cannot breach Articles 101, 102 or 106 TFEU;
- That Camelot's entry into the commercial services markets will not result in any anti-competitive effects;
- That the Commission has failed to take sufficient account of the substantial pro-competitive effects of Camelot's entry into the commercial services markets;
- That, since the Commission is not a designated competition authority within the meaning of EU competition law, it has no power to apply Articles 101 or 102 TFEU (or their domestic equivalents);
- That there can be no breach of procurement law given that the Commission's consent does not extend or affect Camelot's exclusive right to run the National Lottery, and that the possibility of engaging in commercial services was specifically included in the Invitation to Apply for the third licence competition (the "ITA");
- That there can be no breach of State Aid rules given that Camelot's Licence was granted following an open and transparent bidding procedure, resulting in Camelot paying a fair market value for the Licence; and
- That the Commission should have exercised its discretion within the statutory framework afforded to it, and consistently with the Provision of Services Regulations 2009 (the "Provision of Services Regulations").

11. In addition, Camelot expanded on the Remedies Proposal:

- By re-iterating its proposals to address any residual concerns which the Commission may have by way of a condition which made Camelot subject to the Transparency Regulations and a Fair Trading Condition;
- By offering, by way of non-exhaustive examples of additional remedies, the following:
 - Consent to a pilot period during which empirical evidence can be gathered to provide a proper basis for competition analysis and evaluation;
 - A limitation on market penetration to a low percentage of the market; and
 - An obligation to benchmark infrastructure costs to market rates and to price above the appropriate measure of costs;
- By stating it was prepared to offer any appropriate remedy to allay any residual concerns the Commission may have and that it would welcome dialogue as to what those might be.

12. The principal arguments made by the market participants as to why the Provisional Decision was correct and why Camelot's application for consent to undertake commercial services would breach EU and/or UK competition law (and accordingly lead to the UK breaching Article 106 TFEU and/or the Commission breaching its public law duties in the event that consent was granted) can be summarised as follows:

- That there is no obligation or presumption that the Commission should consent to Camelot's proposal, since Camelot has no "right" to diversify into commercial services, but there is a duty on the UK (and therefore on the Commission) not to breach EU law – accordingly, the Commission should not grant consent to Camelot's application unless it can safely rule out any material risk of a breach of Article 106;
- That the causal link between the Commission's grant of consent to Camelot's application to undertake commercial services and any breach of competition law would be established through the fact that, whilst it is not in dispute that Camelot purchased its infrastructure on arms-length commercial terms, it paid for this infrastructure with the proceeds from the National Lottery;
- That the inequalities of opportunity caused by the unmatched advantages, in and of themselves, represent a distortion of competition;
- That the recent case law on Article 106 TFEU requires the grant of a special or exclusive right which is merely liable to create a situation such that the undertaking is induced to commit an abuse, or the measure gives rise to a "risk" of an abuse of a dominant position, for there to be a breach by a member state;
- That Camelot has an extensive network of terminal and related payment infrastructure, a substantial retailer network and significant National Lottery branding advantages which would give it an unassailable position in the market for commercial services;
- That retailers will inevitably prefer to use the National Lottery terminal for commercial services at the expense of rival terminals (either as a result of the

convenience of single terminals or network connections, or as a result of an assumption that it will increase the prospects of gaining or retaining a National Lottery terminal), causing *de facto* bundling;

- That as a result of its unmatched advantages, Camelot would be able to avoid substantial start-up costs as well as reduced operational costs to establish, develop and maintain a successful commercial services business;
- That Camelot's proposal contains a built-in cross-subsidy through its National Lottery activities;
- That in the circumstances, it is highly likely that Camelot would engage in exclusivity practices, both in upstream and downstream markets, and in bundling the National Lottery and commercial services;
- That Camelot's contention that there are no inter-state trade effects is wrong, for example because UK-based operators compete in the commercial services markets with non-UK operators;
- That the grant of consent would constitute a breach of procurement rules because bidders for the National Lottery licence were expressly informed that the Commission would exclude from evaluation of the bids any prospect of financial returns from commercial services;
- That the grant of consent would raise State Aid issues because of the provision of such a significant financial advantage to Camelot which had not been properly market-tested;
- That any collaboration between the monopoly National Lottery provider and the Post Office is likely to constitute an anti-competitive agreement within the meaning of Article 101 of the TFEU; and
- That the Provision of Services Regulations do not apply to this situation given that lottery activities are excluded from their application, and that the Commission's power to grant consent to offer commercial services under Camelot's Licence is not a relevant authorisation scheme under these regulations.

13. In relation to the Remedies Proposal, the market participants made the following principal arguments:

- That the proposed remedies are inadequate to address the concerns in relation to Article 106 of the TFEU (which nothing but an outright prohibition would achieve), since Camelot itself recognises that they only address the issues in relation to Articles 101 and 102;
- That the proposed remedies are insufficient to prevent anti-competitive behaviour effectively, because Camelot would already be subject to the Transparency Regulations, which in any event would only assist the Commission in identifying abuses after they had occurred, and the circumstances in which a Fair Trading Condition can be applied effectively involve incumbent operators in markets in which they have lost, or soon would lose, their monopoly right, and relate to sectors over which the relevant regulator had statutory responsibilities;

- That the Commission does not have any statutory powers which allow it to deal with anti-competitive behaviour in non-Lottery markets (such as commercial services), and in any event, enforcement of these conditions would be extremely costly, burdensome and a serious diversion of the Commission's resources from its core statutory duties; and
- That the market participants cannot rely on the Office of Fair Trading (the "OFT") and/or the EU Commission to enforce any breach of competition law following Camelot's entry into the commercial services markets, given that each has a stated policy or entitlement to act according to its own priorities in enforcement cases.

Analysis of the EU/competition law position

14. Following the Second Consultation, and in light of the points raised, the Commission has taken further advice on the EU/competition law issues from Leading and Junior Counsel (Christopher Vajda QC and Tim Ward). This is in addition to public law advice from Herbert Smith and Nigel Pleming QC. The Commission has also engaged the economic consultants NERA to provide further advice in relation to certain issues in the form of a further report (the "Further NERA Report"), which has informed Leading and Junior Counsel's advice and which will be published on the Commission's website together with this Notice of Decision.
15. In relation to Camelot's argument (based on the Jacobs Opinion), that the Provisional Decision adopted the wrong legal test, Counsel's advice is that this argument is incorrect and proceeds on a mistaken assumption as to the EU law position. The Jacobs Opinion invokes Article 4(3) of Treaty on European Union and Article 52 of the EU's Charter of Fundamental Rights. However, Counsel have advised the Commission that neither of these provisions requires the Commission to adopt Camelot's test (i.e. to grant consent to Camelot's application unless it concludes, on the balance of probabilities, that such consent would infringe Article 106).
16. The Commission has been advised that, in relation to Articles 101, 102 and 106 TFEU, there are two main issues:
 - i. Whether Camelot enjoys an "unmatchable advantage" giving rise to a breach of the principle of equality of opportunity, contrary to Article 106 TFEU; and
 - ii. Whether Camelot's entry into commercial services markets would give rise to a breach of Article 106 TFEU arising out of a "stand alone abuse" by Camelot, namely abuses arising out of Camelot's conduct in those markets, following the grant of permission.
17. In relation to i., the phrase "unmatchable advantage" does not have a specific legal meaning, but has been used by Counsel to mean 'any benefits that would be gained by Camelot in the provision of commercial services derived from its National Lottery monopoly'. The existing market participants have suggested two kinds: a cost advantage gained by Camelot by utilisation of assets for its National Lottery business for the provision of commercial services, and various non-cost advantages, such as association with the National Lottery brand. NERA has been unable to advise the Commission as to

the size of the cost advantage, notwithstanding having had the benefit of the responses to the Second Consultation².

18. In relation to ii., Camelot has assured the Commission that it will not commit such breaches. The market participants have, however, argued that there is a "*high risk of stand-alone breaches*" and indeed that such breaches are "*inevitable*".
19. The Commission has been advised in relation to Article 101, 102 and 106 TFEU on the basis of the Camelot Overview Documents, the responses to the First Consultation and Second Consultation, and the work undertaken by the Commission and its advisers:
 - i. As to whether Camelot would enjoy any unmatchable advantage if in fact it entered into the commercial services markets, NERA's view is that there would be an advantage, although it is unresolved how big that advantage would be, and there remains considerable uncertainty about its effect on Camelot's behaviour and impact on the commercial services markets. Whilst NERA considers that Camelot's entry would result in an increase in short run competition (in the sense of downward pressure on prices), its impact in the long run is unclear. Counsel have advised that despite the absence of direct evidence as to the scale of the unmatchable advantage, and in some respects, uncertainty as to its nature, there are a number of factors (including the barriers to entry to the commercial services markets identified by KPMG, the fact that Camelot wishes to link up its National Lottery networks with its commercial services offering, that it wishes to do so notwithstanding the costs it will incur in doing so by virtue of being the National Lottery operator, and the time and resources which Camelot has spent seeking to persuade the Commission to grant consent) from which they consider an inference may be drawn from Camelot's own conduct and submissions that it would enjoy a material advantage in the commercial services markets as a result of its National Lottery business;
 - ii. As to legal consequences of any such advantage there is a risk that existing case law on 'inequality of opportunity' may be applied to an unmatchable advantage in the present case;
 - iii. As to standalone breaches, the key issues are (i) the factual question of whether any such breach would occur, and (ii) the causal link needed between a stand-alone abuse committed by Camelot following any grant of its application for consent to undertake commercial services and the liability of the Commission under Article 106 TFEU. The test for causation in this context is uncertain in light of the case law of the European Court. Even assuming that the causation test were satisfied, the Commission is not in the position to resolve the factual dispute;
 - iv. Camelot is not correct to say that there is "*no realistic prospect that a grant of permission to offer commercial services would be held to infringe Article 106(1)*". On the contrary, Counsel cannot advise the Commission that there is no significant (that is to say, material) risk under Article 106 TFEU if it grants consent to Camelot's application. In light of the continuing factual and legal uncertainty, it is, however, not possible to be more specific about the

² The Further NERA Report, pages 8-12.

risk. It should not, however, be inferred that any such risk may be far-fetched. On the contrary, there is a substantial basis for these concerns. Moreover, Counsel have advised that if the advantage(s) were shown to be economically significant, the risk of breach would be significant; and

- v. In relation to Article 101 TFEU, Camelot's response to the Second Consultation contained no further details on the proposed agreement with the Post Office, which is what gives rise to the concerns under Article 101. In the absence of any indication as to the content of any such agreement, Counsel are unable to express a view as to its implications.
20. In relation to the EU/competition law concerns arising from the EU Treaty principles of transparency and non-discrimination associated with procurement law, Counsel have advised the Commission that, on balance, granting consent to Camelot's application would not infringe these principles.
21. In relation to State Aid (Article 107 TFEU), Counsel have advised the Commission that the obligation of the Member State when granting a licence is to avoid discrimination between bidders for that licence, rather than seeking to obtain "full value", and therefore if the arguments advanced under the heading of procurement law do not succeed, any arguments challenging any decision to grant consent to Camelot's application in relation to State Aid would be unlikely to succeed.
22. In relation to the Provision of Services Regulations, Counsel have advised that these regulations do not apply in this case.

Whether the Commission should conduct further work

23. In the Provisional Decision, the Commission proceeded on the basis that there would be significant difficulties in carrying out the further work needed to reach a firmer view on the EU/competition law issues, and that even if it was carried out, this may well fail to generate sufficient certainty for the Commission to be satisfied that granting consent would not give rise to a significant risk of a breach of EU/competition law.
24. As set out in paragraph 19 i., it remains unresolved how big Camelot's unmatched advantage would be, or the nature of its impact on competition. The Commission has been advised that, in principle, it would be of considerable assistance to have reliable information about the scale of Camelot's cost advantages, and desirable, if further enquiries into this are conducted, also to carry out additional further enquiries into any non-cost advantages which Camelot would have, and whether Camelot could be said to have 'paid' for any advantage arising out of the National Lottery.
25. NERA has advised the Commission that "*somewhat more reliable information about the nature and scale of Camelot's cost and non-cost advantages*"³ than is currently available could be obtained by conducting a series of further enquiries. NERA has advised that the most promising way to obtain useful information on cost advantages would be to invite Camelot to provide an additional set of cost estimates based on the assumption that the commercial services are to be provided independently of its National Lottery activities⁴. If the Commission wished to verify any such estimate, NERA has advised that it would need

³ The Further NERA Report, page 15.

⁴ The Further NERA Report, page 12.

to locate and instruct an independent expert to perform that task⁵. The Commission considers that in light of NERA's advice, it would wish to conduct such a verification exercise if the proposed exercise were to be undertaken.

26. In terms of timing, NERA has advised that:

- *“It is difficult to predict how long it would take Camelot to generate a revised ‘standalone’ cost estimate, or for the [Commission] to locate and engage an appropriate independent expert, and for that expert to carry out the required analysis. In very broad terms, we would expect that this additional analysis and verification would take at least one month, and even this would only be possible if Camelot could respond quickly and if an expert could be identified who was already familiar with the different types of technology used to provide commercial services... It is difficult to say how much longer the analysis could take if either Camelot cannot provide its standalone cost estimates quickly or if the independent expert needs to undertake significant new primary research, but a period of three months or longer cannot be ruled out.”*
- *“Significant additional time, perhaps another 1-2 months, would be required if existing suppliers were involved in the review process as well. This does not allow for any up-front time required, for example to agree and implement any necessary confidentiality arrangements (though it might be possible that this could be progressed while Camelot and/or the independent expert are still carrying out their analysis). Additional time, beyond this, might also be required to analyse the responses and consider their implications.”⁶*

27. The Commission has been advised that, in all likelihood, the market participants would have to be consulted on any estimates produced by Camelot (subject to difficult issues on confidentiality) given that they are evidently in a position to materially assist the Commission in determining this issue.

28. As to the likely value of such an exercise, NERA has advised that:

“Provided a suitable independent expert can be recruited, then we believe this analysis would provide a reasonable prospect of providing a reasonable estimate of the likely size of Camelot’s cost advantage. But this cannot be guaranteed and this additional analysis would not provide information about the likely importance of any non-cost advantages.

...

However, unless the analysis reveals that the cost advantage is either very small (with a low likelihood of material competitive impact) or very large (eg it makes the difference between Camelot entering and not entering the market), there may remain considerable uncertainty as to how the cost advantage is likely to affect Camelot’s behaviour and the market for commercial services.”⁷

29. In relation to the likely competitive impact of Camelot's entry into the commercial services markets, NERA has advised that an appraisal of the nature and intensity of competition in a

⁵ The Further NERA Report, pages 12-13.

⁶ The Further NERA Report, page 13.

⁷ The Further NERA Report, pages 13-14.

market, and the impact of the entry of an additional competitor, is a complex exercise that demands a more in-depth examination than KPMG has provided⁸. NERA has advised that the work necessary to undertake a better founded analysis than that provided by Camelot (in the report produced by KPMG) could entail the following:

“We anticipate that the process required to undertake such an exercise would involve significant research, requests for information from the industry and market testing of the information received. One possible process would be broadly along the following lines:

- *Stage 1: issue an information request to Camelot, incumbent suppliers and customers (both retailers and customers wishing to offer electronic bill payments to their consumers). In the case of retailers – who are particularly fragmented – this may need to be in the form of a market survey.*
- *Stage 2: analyse and market test the responses, issue follow up requests and complete the market impact assessment.”*⁹

30. The Commission has been advised that it lacks the statutory powers to require the co-operation of the existing retailers in order to conduct this exercise in the absence of co-operation. As to the duration of such an exercise, NERA has advised:

“Assuming prompt replies to the information requests, the time line for such a process would likely be comparable at minimum to the time taken by the Competition Commission to review a merger that has been referred to it for detailed investigation (around six months), and a longer time period may be necessary . . . The competition authorities have substantially longer time to conduct a market investigation case (than a merger case), and as NERA previously noted, competition authorities often take years to assess an exclusionary abuse case.

*While the above will provide a better basis for assessing the competitive impact of Camelot's entry into the provision of commercial services, the findings may not be conclusive, in particular because of the unavoidable and increasing uncertainties that accompany any attempt to predict developments further into the future.”*¹⁰

31. In relation to non-cost advantages, NERA has advised that such advantages:

*“would be very difficult to evaluate, as we are not aware of any recent comparable situation that could shed light on retailers' likely decisions, in practice, when confronted with the specific advantages (and disadvantages) that Camelot's commercial services would offer. Some additional information could be obtained by consulting directly with retailers, or with experts that can offer insights into retailer behaviour. But even in this case, the results would be based on hypothetical questioning, which may not be a good indication of how retailers would react in practice when faced with specific commercial propositions (covering both the commissions on offer to the retailer and also the specific range of services offered through each terminal, some of which may be exclusive).”*¹¹

⁸ The Further NERA Report, page 20.

⁹ The Further NERA Report, pages 31-32.

¹⁰ The Further NERA Report, pages 32-33.

¹¹ The Further NERA Report, page 15.

32. In deciding whether to commission this further work, the Commission has taken into account the following summarised advice and considerations. In favour of doing so:

- The Commission has an obligation to conduct adequate enquiries;
- In principle it would be of considerable assistance to have reliable information about the scale of Camelot's cost advantages, and desirable, if further enquiries into this are conducted, also to conduct certain additional enquiries¹²; and
- NERA has identified a specific programme of further work that could be conducted in a matter of months which they say would provide "*somewhat more reliable information about the nature and scale of Camelot's costs and non-cost advantages*".

33. Against doing so:

- NERA's proposals would require the investigation and evaluation of matters which lie outside the Commission's area of expertise;
- Further external experts (in the form of technical consultants) would be required;
- In all likelihood, yet further consultation would be required in respect of the fruits of that exercise (subject to difficult issues on confidentiality in relation to sharing at least some commercial information that may be obtained);
- Such a consultation exercise may open up scope for argument on a wide range of points that may further prolong and extend the scope of the Commission's task;
- Camelot and the market participants have now been provided with two opportunities (the First Consultation and the Second Consultation) to provide the Commission with information in relation to the likely nature and scale of the advantage, and the Commission has considered each of their responses;
- It is not certain that further work would provide information to assist the Commission;
- Such a course of action would cause considerable delay to the Commission's decision; and
- Counsel have advised that there are a number of factors¹³ from which an inference may be drawn from Camelot's own conduct and submissions that it would enjoy a material advantage in the commercial services markets as a result of its National Lottery business.

Whether the EU/competition law issues can be addressed through the use of conditions

34. As described above, following the Provisional Decision, Camelot provided the Remedies Proposal to the Commission. Camelot has also expanded on the Remedies Proposal in its response to the Second Consultation.

¹² See paragraph 24 above.

¹³ See paragraph 19.i. above.

35. The remedies were proposed by Camelot Group plc (now Camelot UK Lotteries Ltd). NERA has identified that the Transparency Regulations remedy would not be effective unless it was extended to cover the company which will undertake the commercial services, Wholesale Commercial Services Limited ("WCSL"), which is owned by Camelot's shareholders, but not regulated by the Commission. Counsel have advised on the assumption that Camelot would be prepared to undertake to extend any remedy that the Commission considered appropriate to WCSL as well as the regulated entity. Whilst Camelot has not been asked whether it would be prepared to do this, and the practicalities of doing so have not been explored, Counsel have proceeded on this assumption in Camelot's favour in order to consider the potential efficacy of the remedies.
36. Under the Transparency Regulations remedy, Camelot would be required to provide the Secretary of State for Business, Innovation and Skills with certain information about its costs and revenues. Camelot has also offered to make this information available to the Commission, the OFT and to "*the advisers of complainant third parties*". It argues, among other things, that this remedy would have a deterrent effect.
37. As to the proposed Fair Trading Condition, Camelot has explained that this condition is modelled on the text used by OFCOM in broadcasting licences. Under the Fair Trading Condition, Camelot proposes that the Commission could use "*additional powers of direction and/or guidance under this arrangement to require that Camelot submit information, such as proposed pricing strategies, agreements or other information to an appropriate competition regulator or such other person ... as it may direct. This might include the advisers of third party complainants.*" It further proposes that "[t]he Commission might further use the powers of direction under this arrangement to require that Camelot draw up and adhere to a competition law compliance code of conduct in relation to commercial services. It could require Camelot to appoint an individual within the company to have specific responsibility for monitoring adherence to the code, investigating third party complaints and reporting upon compliance with the code to the Commission, or such body as the Commission may specify, on a periodic basis."
38. Counsel have advised that the Transparency Regulations remedy and/or Fair Trading Condition potentially provide the means to address any alleged breaches of competition law arising out of Camelot's conduct in the market. The proposed provision of information to third parties would also be of considerable assistance to them in determining that question. Whilst the Transparency Regulations remedy would not address some of the forms of breach that the market participants have raised concerns about (such as the prospect that Camelot will "*bundle*" its National Lottery and commercial services products together), as Camelot rightly says, the effect of the Fair Trading Condition would be to make consent "*conditional on Camelot observing competition law.*"
39. Whilst Camelot suggests that information could be passed under these remedies to the advisers of third parties, any enforcement of these conditions by the Commission would require analysis of the information provided under the Transparency Regulations, and a willingness to investigate alleged breaches of either condition.
40. It appears, however, on the basis of NERA's advice that these remedies would not provide a practical means to address "unmatchable advantages". NERA has advised the Commission that:

"Neither of these remedies would appear suitable for addressing all of the potential problems that may arise if the legal view is that economies of scope

(including both cost and non-cost factors) from the National Lottery business give Camelot an unfair advantage that needs to be addressed. The financial transparency conditions will provide information about Camelot's actual costs, including an allocation of common costs, but they will not provide information about what these costs would have been if there were no economies of scope with Camelot's Lottery business. Neither will they provide any information about Camelot's non-cost advantages. In addition, even if they were able clearly to identify Camelot's cost advantage, they would not address it.

Similarly, while a fair trading condition might help to prevent further competition problems (for example, resulting from tying arrangements or below-cost pricing), it is unlikely that such a condition could be designed so as to neutralise the impact of the cost and non-cost advantages that Camelot enjoys because of its Lottery business (if the legal view is that these need to be addressed)."¹⁴

41. Camelot's Second Consultation response suggested certain further remedies, namely consent to a pilot period, a limitation on market penetration and an obligation to benchmark infrastructure costs to market rates and price above the appropriate measure of costs. Camelot emphasised it was prepared to offer "*any appropriate remedy to allay any residual concerns the Commission may have and would welcome a dialogue as to what those might be*".
42. NERA has considered these further remedies. They have advised the Commission that the first, a pilot period, "*does not appear to be a 'remedy' as such.*"¹⁵ As to the second two, they have identified a series of significant issues in seeking to formulate the details of how the remedies would function, and conclude that there are "*significant practical difficulties*"¹⁶ in seeking to implement them. In light of NERA's advice, Counsel have advised that these remedies raise a number of formidable practical and conceptual difficulties. They would require the Commission to exercise an ongoing and intensive supervisory role, to grapple with difficult and potentially highly contentious questions of economics and to obtain information about the commercial services markets, notwithstanding that it lacks the statutory powers to compel market participants to provide such information. Thus, any attempt to regulate the question of unmatched advantages through the imposition of conditions would require the Commission to take on a complex new role.
43. There is an evident prospect that the grant of consent to Camelot to undertake commercial services may lead to complaints to the Commission by third parties (such as the market participants) asking the Commission to enforce the conditions contained in the Licence in respect of alleged breaches of competition law, notwithstanding Camelot's assertion that it proposes to comply with competition law.
44. As the foregoing makes clear, Camelot has suggested that information might be provided to the advisers of third parties as part of its Remedies Proposal. Camelot's consultation response argued:

"We submit the Commission should first consider whether the existing fora for remedial action, the competition authorities and the courts, are sufficient to deter

¹⁴ The Further NERA Report, page 5.

¹⁵ The Further NERA Report, page 6.

¹⁶ The Further NERA Report, pages 7-8.

and address any competition concerns the Commission may have ... [The Transparency Regulations] provides one such structural mechanism for detection and deterrence. The Commission might also take the view that rival commercial services operators are resourceful and sophisticated organizations able to avail themselves of remedies before the competition authorities or courts if they have a complaint as to how Camelot may conduct itself in the future. Those mechanisms are considered generally satisfactory methods of recourse across all industries for competition law concerns. There are substantial penalties for breach of competition law and damages available to those harmed. Even if Camelot had not already committed to act entirely properly in relation to its new business, these dissuasive sanctions are likely to ensure that Camelot has strong incentives to act lawfully in relation to the new business.”

45. Counsel have advised that this argument is not sufficient to absolve the Commission of all responsibility for regulating the competition implications of Camelot’s entry into the commercial services markets.
46. First, the Commission is itself potentially liable for a breach of Article 106 TFEU whether as a result of Camelot’s entry into the commercial services markets, or by reason of “stand-alone” breaches of Articles 101 and/or 102 TFEU. The prospect of the kind of enforcement by others envisaged by Camelot does not suffice to protect the Commission from this risk.
47. Second, whether or not competition-specific conditions are applied, the terms of Camelot’s existing Licence are such that a breach of competition law by Camelot (or WCSL¹⁷) would potentially give rise to a breach of Camelot’s Licence. This is not to say that the Commission would be required to take on the role of a competition regulator, such as the OFT. Rather, notwithstanding the existence of such regulators, the Commission may be called upon to consider such competition issues as part of its function of regulating Camelot under the terms of its Licence. This issue would become particularly acute in circumstances where, for example, a market participant asked the Commission to investigate a complaint in circumstances where the OFT had declined to do so on grounds of administrative priorities.
48. Third, it could also be argued that it could give rise to a breach of the Commission’s duty to exercise its functions in a manner they consider to be most likely to secure that the National Lottery is run with all due propriety: if Camelot were to act in breach of competition law in the provision of commercial services, and the Commission either permitted this, or knew that it would be unable to rectify the breach, it might be argued that this is a failure of propriety in respect of the National Lottery.
49. Counsel have advised that a further consideration arises in respect of the Commission’s obligations under the terms of its Licence in regard to competition law. As has been noted, Camelot has argued that there is no realistic prospect that the grant of permission would give rise to a breach of Article 106 TFEU, whether on the basis of unmatchable advantages or stand-alone breaches. Even if it is assumed that Camelot’s argument in this regard is correct, difficult issues of competition law may still arise for the Commission if Camelot enters the commercial services markets.

¹⁷ Condition 6.9 imposes an obligation to ensure that any Ancillary Activity is appropriate and in accordance with the reputation and image of the National Lottery. The Commission has been advised that that extends to ensuring that Ancillary Activities are conducted lawfully, whether by Camelot or by another company such as WCSL.

50. As explained above, the Commission may face complaints of a breach of competition law by Camelot (whether Article 101 and/or 102 TFEU or their domestic equivalents, the Chapter I and II prohibitions contained in the Competition Act 1998¹⁸). Conduct in breach of those provisions may itself give rise to a breach of Camelot's Licence. That is so even if Camelot's argument on Article 106 TFEU is correct, and there is no prospect of liability on the part of the Commission itself for breach of competition law, and the concerns identified by Counsel in respect of "unmatchable advantages" are unfounded. Thus, to give examples highlighted by the market participants, there may be a complaint that Camelot has engaged in unlawful cross-subsidy, or bundling as between the National Lottery and the commercial services it offers.
51. Faced with such a complaint, if it were to arise, the Commission would then have to consider whether to exercise its discretion to investigate and enforce the terms of Camelot's Licence.
52. The investigation of such complaints will be likely to require the Commission to engage with complex questions of law and economics arising in the commercial services markets, where it lacks expertise and compulsory statutory powers.
53. The following legal principles are applicable:
- The Commission has a discretion both as to when to take enforcement steps in respect of the Licence and in relation to the nature and extent of any investigation it decides to conduct.
 - In exercising that discretion, it must take into account relevant matters, and disregard irrelevant matters. It is relevant that the Commission is not an expert competition regulator. It has no expertise, or wider regulatory function in respect of the commercial services markets. There are expert regulators in the form of the OFT and the European Commission (although they may of course have declined to act at a time when the Commission is called upon to do so). Thus, it may be appropriate in a particular case for the Commission to undertake a more limited form of enquiry than might be appropriate for an expert competition regulator, with a general jurisdiction over the commercial services markets, or even to decline to act altogether. These are questions which the Commission would have to address on a case-by-case basis.
 - The Commission is also entitled to have regard to the implications for management time and cost of seeking to investigate such issues. It is not obliged to devote unlimited resources to particular issues, especially ones which are not core issues for the Commission such as the commercial services, albeit that they are projected to generate substantial sums for good causes.
 - It is also relevant to the exercise of that discretion that Camelot's proposed remedies would serve to improve the ability of third parties (such as the existing market participants) to seek remedies through the courts against Camelot's conduct, as well as providing a deterrent to Camelot in the first place.
 - Nevertheless, it is not open to the Commission to adopt a rigid policy whereby it will *never* investigate any of the competition issues that may arise under the terms of the Licence. The imposition of specific conditions intended to reduce the risk of

¹⁸ The Chapter I and II prohibitions are to materially the same effect as Articles 101 and 102 TFEU.

a breach of competition law would serve to strengthen the Commission's obligation to investigate competition law issues that arise under the Licence, and the Commission could not impose such conditions and yet adopt a policy that it would never enforce them.

- Given the competition law advice that the conditions offered by Camelot would be beneficial for tackling at least some of the competition law issues that have arisen (or, as noted above, which may arise), and given the lack of factual certainty as to the implications of Camelot's entry into the commercial services market, it would be unsafe for the Commission to grant permission yet decline to impose these, or comparably effective, conditions.
- In determining its course of action, the Commission is entitled to take into account the complexity of the competition and economic issues raised by Camelot's proposal, and that the enforcement of the terms of Camelot's Licence (whether with or without competition-specific conditions) in respect of its commercial services may require the Commission to engage with complex questions of law and economics arising in the commercial services markets, where it lacks expertise and compulsory statutory powers.

The Commission's Decision

54. In exercising their discretion, the Commissioners have taken into account the Commission's statutory duties, insofar as they apply to the commercial services proposal. In addition, they have considered other factors or issues arising, either through the First Consultation or Second Consultation, or through their own consideration of Camelot's application for consent to undertake commercial services, that do not fall within the Commission's statutory duties. The Commissioners are entitled, in exercising their discretionary power, to grant or refuse consent – subject always to competition and public law considerations (including the Commission's obligation to reach a decision that is fair and reasonable and, as a matter of prudence, proportionate).

Considerations

55. Given the advice which the Commission has received relating to the risks of breach of EU/competition law, the Commission has made its assessment as to whether to grant or refuse consent to Camelot's application to undertake commercial services based on a balance of the matters set out above and, in particular, having regard to the following considerations:

- i. Camelot's proposal, if and when implemented, is estimated by Camelot to generate in excess of £5 million per annum for good causes;
- ii. The fact that the competition law position is very uncertain given the novel factual situation and the inconsistent case law on a number of the EU/competition law issues that the proposal raises;
- iii. Notwithstanding this uncertainty, the Commission has been advised that it cannot conclude that there are no significant (that is to say, material) risks of breach of EU/competition law;
- iv. The impact on the reputation and propriety of the National Lottery in the event of a (successful) legal challenge to any decision, whether that is to

grant or refuse consent, but particularly in the event that a decision to grant consent is successfully challenged on the basis that it is unlawful on EU/competition law grounds;

- v. There is a very high prospect that implementation (and the generation of these returns) would be delayed (perhaps by as long as two years) because of likely litigation in relation to any grant of consent, particularly in light of the risk of a damages claim against the Commission in the absence of an injunction or consent order, although there would remain a significant amount of time to run on Camelot's Licence, during which commercial services could boost returns to good causes;
- vi. The cost in management time and expense in undertaking the identified further work in order to reach a firmer view, including as to the scale and impact of Camelot's cost advantage;
- vii. The lack of confidence that the further enquiries would be of significant assistance, or conclusive, particularly in light of the work undertaken so far;
- viii. The Commission's lack of a more general regulatory function in respect of the commercial services markets, lack of regulatory powers in respect of the existing market participants in the commercial services markets, and consequential lack of expertise in those markets;
- ix. The resources, expertise and lack of regulatory powers, including compulsory statutory information gathering powers, that the Commission has: (a) to perform the necessary market and other analysis to allow the Commissioners to exercise their discretion in a way that comprehensively analyses competition law concerns; and (b) to regulate the implementation of the application for consent to undertake commercial services by enforcing any conditions it imposes, or ensuring that, in any event, Camelot operates the commercial services in accordance with its Licence;
- x. Whilst some of the remedies proposed by Camelot could reduce the risk of a breach of EU/competition law, there would be formidable practical and conceptual difficulties in seeking to remedy unmatched advantages through the proposed conditions.
- xi. The cost in management time and expense of the Commission having responsibility for monitoring and enforcement of the Licence in regard to any potential breach of competition law arising out of the provision by Camelot of commercial services, and in particular in respect of the enforcement of any conditions that Commissioners consider are necessary for any decision to grant consent to Camelot's application, and the Commission's lack of expertise in such enforcement activity in regard to the competition issues raised by the application;
- xii. The costs in management time and expense, for both Camelot and the Commission, in operating and monitoring, respectively, the commercial services in circumstances whereby their core functions are the operation and regulation of the National Lottery. This is in the context where the

core lottery business generates c£1.6 billion a year for good causes and the commercial services are estimated by Camelot to generate in excess of £5 million per year for good causes;

- xiii. The fact that, if consent is given to the application, it will take some time, taking into account start-up costs for example, for the provision of commercial services to generate profits (and hence returns to good causes);
- xiv. The fact that Camelot has stated that it is prepared to offer any appropriate remedy to allay any residual concerns the Commission may have and that it would welcome dialogue as to what those might be; and
- xv. The fact that the responses of some retailers to the First Consultation and the Second Consultation have referred to the potential for a pro-competitive impact of Camelot's entry into the commercial services markets.

Rationale

- 56. The Commission has said that it would, subject to the matters set out in the ITA, expect to consent to Ancillary Activities which generated a fair return to good causes. The ITA made clear that *"the Commission needs to ensure that . . . Any exercise of the Commission's discretion to give consent would be lawful, including having regard to competition law considerations."*
- 57. The Commission has been advised that it cannot be concluded that there is no significant (that is to say, material) risk of a breach of EU/competition law were it to grant consent to Camelot's application to undertake commercial services (as set out in its proposal). This advice has been reaffirmed following consideration of the responses to the Second Consultation. The Commission has concluded, therefore, that it should not give unconditional consent to Camelot's application.
- 58. The Commission has then considered whether conditions could be devised which would mitigate the risk of a breach of Article 106 TFEU to the point where it was no longer significant (that is to say, material). The Commission has decided not to grant consent to Camelot's application with conditions. In reaching this decision, the Commission had particular regard to the following:
 - Whilst the Commission is advised that conditions could resolve some of the EU/competition law issues identified, it is also advised that any attempt to deal with the issue of unmatchable advantage through the imposition of conditions raises a number of formidable practical and conceptual difficulties. The Commission, on advice, has concluded therefore that any remedy for unmatchable advantages is so problematic as not to be practicable and that, as a result, any further dialogue with Camelot regarding appropriate remedies to allay any residual concerns would be fruitless;
 - The Commission is advised that the Transparency Regulations remedy would not address some of the forms of breach that the market participants have raised concerns about;

- The imposition of conditions (and, in particular, the Fair Trading Condition, the limitation on market penetration and the benchmarking of infrastructure costs) would bring with it a responsibility on the Commission to:
 - Analyse and act upon information provided as to Camelot's activities in the commercial services markets pursuant to the Transparency Regulations remedy;
 - Take on a burden of investigation and, if appropriate, enforcement of the Fair Trading Condition (and any other condition adopted) in the commercial services markets;
- The Commission is not well placed to undertake such investigations and enforce such conditions as it lacks the more general regulatory functions, the compulsory statutory powers and consequently the core expertise in respect of the commercial services markets to do so; and
- There is a strong likelihood that there would be further complaints about Camelot's conduct and its compliance with conditions and/or the Licence which the Commission would be obliged to consider. These issues are likely to require the Commission to engage in complex questions of law and economics in order to investigate and enforce them.

59. In relation to the Provision of Services Regulations, the Commission, as already noted above, is advised that they do not apply.

60. The Commission has also considered whether to pursue further enquiries to seek to resolve the uncertainties that have been identified in the advice such that it could reach a firm view on whether the risk of a breach of Article 106 TFEU is significant (that is to say, material) or not. The Commission has decided not to pursue further enquiries before taking its decision. This was a finely balanced and difficult decision, but the Commission has concluded that the factors in favour of undertaking further work are outweighed by the factors against doing so. In reaching this conclusion, the Commission had particular regard to the following:

- No clear resolution of the uncertainties has emerged from the responses to the Second Consultation, despite the fact that the Provisional Decision had clearly identified the Commission's concerns about the factual uncertainties surrounding the risk of a breach of Article 106 TFEU;
- The Commissioners are not confident that pursuing such further enquiries would provide sufficient clarity to reach a firm view on whether the risk of a breach of Article 106 TFEU is significant (that is to say, material) or not, given:
 - The real possibility that there would remain considerable uncertainty as to how the cost advantage is likely to affect Camelot's behaviour and the impact of Camelot's entry on the commercial services markets;
 - The lack of regulatory powers, including compulsory statutory information gathering powers, that the Commission has with which to perform the necessary market and other analysis in a way that comprehensively analyses competition law concerns;

- That the analysis would require the investigation and evaluation of matters which lie outside the Commission's area of expertise, such that further external experts would be required;
 - The low likelihood of gathering conclusive information about the size of 'non-cost' advantages;
 - That such a consultation exercise is likely to open up scope for argument on a wide range of points that may further prolong and extend the scope of the Commission's task;
- The considerable delay that pursuing such further enquiries would cause to the Commission's decision, especially as the Commission is advised that such an exercise would lead, in all likelihood, to yet further enquiries and a further consultation exercise (subject to difficult issues of confidentiality); and
 - The public interest in coming to a decision.
61. The Commission recognises that it would clearly be desirable, and in accordance with the Commission's duty to maximise the returns to good causes, subject to the statutory propriety duty, to allow a proposal which might be capable of being implemented lawfully and that Camelot estimates would generate in excess of £5 million per annum for good causes. However, the Commission notes that:
- The additional contributions will only be achieved if a route can be found to enable commercial services to proceed without raising a material risk of breach of EU/competition law. It is very uncertain that this can be achieved, and, even if it could, there is a very high prospect that implementation (and the generation of these returns) would be delayed;
 - The Commission's costs of reaching such a position, including the undertaking of further analysis and devising conditions, are provided ultimately from returns to good causes;
 - The Commission's costs of operating any consequential regime, including the costs of investigation of Camelot's conduct and enforcement of conditions of consent, together with the costs of dealing with challenges from third parties (such as the existing market participants), are met ultimately from returns to good causes; and
 - The potential distraction which such a regime is likely to pose to both Camelot's and the Commission's focus on the operation of the National Lottery, which is the main purpose of both organisations and by far the major source of returns to good causes.
62. Given the advice that the Commission has received, the Commission has decided not to consent to Camelot's application to undertake commercial services because the Commission has been advised that it cannot be concluded that there is no significant risk of a breach of Article 106 TFEU. This cannot, in practice, be remedied by the imposition of conditions attached to consent. Further work would be required to seek to resolve the uncertainties that have been identified in the advice and, as explained above, the Commission has decided not to undertake that work.

63. Whilst the Commission considers that the application should be refused on the foregoing basis, it further considers that, irrespective of the question of whether Article 106 TFEU may be infringed, if the Commission were to grant consent to Camelot's application to undertake commercial services, it may be called upon to investigate alleged breaches of Camelot's Licence arising out of EU/competition law issues arising in the commercial services markets, in circumstances where the Commission lacks the expertise and the compulsory statutory powers to resolve those issues.
64. Finally, it should be noted that, aside from the EU/competition law issues, the Commission has made it clear (see paragraph 29 of the Provisional Decision) that other issues would have needed to have been resolved prior to any consent to Camelot's application to undertake commercial services being granted. In circumstances where the Commission has now decided to refuse consent on the basis of concerns arising out of EU/competition law issues, the Commission has decided not to continue further with its inquiry into these remaining issues.

ANNEX – STATEMENT OF REASONS ON THE PROVISIONAL DECISION

The Commission's notice of provisional decision is available on our website here:

http://www.natlotcomm.gov.uk/assets-uploaded/documents/commercial-services-statement-of-reasons_1279263204.pdf

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