

# DAILY FANTASY SPORTS: An Industry in Flux



## An analysis of state-by-state approaches to DFS<sup>1</sup>

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The popularity of fantasy sports has exploded in recent years with the rise of daily fantasy sports (“DFS”). The popularity of DFS stems from the excitement of being able to select a new variation of athletes on a daily basis, seven days a week and 365 days a year. Unfortunately for DFS operators, the increased popularity of DFS, along with allegations of a DFS employee exploiting insider information, has also led to the questioning its legality and an outcry for regulation of the industry. As of March 1, 2016, legislation was pending in 28 states concerning the regulation of DFS and its legality under state law. While some states have moved expressly to legalize DFS, such as Virginia, and other states

have proposed regulations to regulate DFS, such as Massachusetts, DFS has been historically prohibited in other states, such as Arizona, Iowa, Louisiana, Montana and Washington. Further, state Attorneys General, such as those in Mississippi and New York, have recently taken steps to prohibit DFS within their states, and state gaming regulators, such as those in Nevada, have deemed that DFS constitutes gambling that may only be offered pursuant to a state gaming license. The varied approaches to DFS in several jurisdictions are considered below, along with the Unlawful Internet Gambling Enforcement Act of 2006 (“UIGEA”), which rests at the forefront of the debate concerning the legality of DFS.

## I. UIGEA

UIGEA's primary prohibition states that individuals in the business of betting or wagering may not knowingly accept, in connection with the participation of another person in "unlawful Internet gambling," credit, electronic fund transfers, checks or the proceeds from certain other transactions. Under UIGEA, the determination as to whether a person participates in unlawful Internet gambling is a matter of state law. In other words, UIGEA's prohibition is generally only applicable where the relevant bet or wager is unlawful under state law.

To be considered unlawful Internet gambling under UIGEA, however, a "bet or wager" must occur in the first instance, and under UIGEA, "bet or wager" excludes participation in fantasy sports contests in which the fantasy sports team is not based on the current membership of an actual team, prizes are established before contests begin and their value is not based on the number of players or their fees, and winning outcomes reflect the skill of the players, are predominantly based on statistics of athletes in actual events and are not based on scores, point spreads or the performance of any team or single individual athlete ("Exemption").

UIGEA, however, expressly states that it is not intended to alter or limit other federal or state laws prohibiting, permitting or regulating gambling within the United States, and as noted above, participation in unlawful Internet gambling is a matter of state law. In short, the Exemption simply excludes fantasy sports from UIGEA in that fantasy sports are not criminalized under UIGEA, does not legalize fantasy sports or deem that they are not "gambling" and does not limit or preempt state laws concerning gambling. Accordingly, even if DFS contests are excluded from UIGEA's restrictions and regulations at a federal level, the legality of DFS contests must be considered on a state-by-state basis under state gambling laws.



## II. Nevada

On October 15, 2015, the Nevada Gaming Control Board ("NGCB"), along with the Gaming Division of the Office of the Nevada Attorney General, concluded that DFS constitutes gambling under Nevada law as DFS met the definition of "gambling games." Further, as DFS involves wagering on the collective performance of individuals participating in sporting events, a license to operate a sports pool is required to offer DFS within Nevada. While the NGCB's ruling permits current Nevada licensees with approval to operate a sports pool to offer DFS within Nevada, DFS operators were obligated to cease operations in Nevada until such time as they filed for and obtained the appropriate license.

The NGCB based its ruling on the definitions of "gambling game" and "sports pools" under Nevada law. The NGCB opined that DFS constituted a game played with any electronic device and that it was played for money or any other representative value, and thus, DFS was considered a gambling game. Further, as DFS was a game in which patrons could wager against each other and the

"house" takes a percentage of each wager, DFS could also be considered a "percentage game," and therefore, a gambling game. Further, the NGCB concluded that DFS contests constitute sports pools as they involve wagering, that such wagering is made on sporting events by a system of wagering and that DFS operators are in the business of accepting wagers. As a license is required to operate a gambling game or sports pool, DFS operators could not continue to operate without such a license.

As the definitions of "gambling game" or "sports pool" under Nevada law do not require chance or some element of chance, and make no distinction between games of skill and games of chance, the NGCB did not opine as to whether DFS was predominately driven by skill or by chance. However, the NGCB did state that DFS may constitute a prohibited lottery, in which case it would be necessary to consider whether DFS was predominately driven by chance rather than skill.

To-date, traditional DFS operators, such as FanDuel and DraftKings, have not applied for a license to operate in Nevada. However, a new entrant into the market, US Fantasy, whose DFS product is designed to operate similar to off-track, pari-mutuel horse racing, and in conjunction with existing regulations, recently applied to the Nevada Gaming Commission for a license.



## III. New York

The New York State Constitution expressly prohibits gambling in all forms not specifically authorized, and the New York State Legislature has passed laws to criminalize such gambling, including Section 225.10 of the New York Penal Law, which criminalizes the promotion of unlawful gambling activity. Under New York law, "gambling" requires a wager on a "contest of chance or a future contingent event not under his control or influence." Generally, there are three tests used by states to determine whether a particular contest is a contest of chance: (1) the predominance test, in which the element of chance is present if chance predominates over skill, even if skill plays a role in the contest; (2) the any chance test, in which the element of chance is present if the contest has even the slightest degree of chance; and (3) the material degree test, which has been adopted in New York, in which a "contest of chance" means any contest where the outcome depends in a material degree upon an element of chance. Accordingly, the debate surrounding DFS in New York revolves primarily around whether DFS outcomes depend in a material degree upon chance.

In a November 2015 cease-and-desist letter, New York State Attorney General Eric Schneiderman opined that DFS patrons were placing bets on events outside of their control or influence (the performance of professional athletes) and that each DFS wager represented a wager on a "contest of chance." Accordingly, Attorney General Schneiderman concluded that DFS constituted gambling under New York law, and thus was prohibited under the New York State Constitution and several sections of the New York Penal Law.

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Attorney General Schneiderman subsequently filed Complaints in the New York Supreme Court seeking injunctions enjoining DraftKings and FanDuel from operating within New York, and in December 2015, Amended Complaints also seeking civil penalties for alleged deceptive acts and false advertising, including \$5,000 for each individual violation, disgorgement of monies received and restitution of consumer funds. Asserting that DFS contests are games of skill, DraftKings and FanDuel sought a temporary restraining order concerning the cease-and-desist, and preliminary injunctions enjoining further actions that allege DFS violates New York law. On December 11, 2015, the New York Supreme Court granted the Attorney General's request for injunctive relief, thus prohibiting DraftKings and FanDuel from operating within New York. The New York Supreme Court Appellate Division's First Department, however, granted an interim stay of the injunctions on the same day, and more recently, granted a permanent stay of the injunctions pending resolution of appeals from the December 11, 2015 order, which is not expected before May 2016. While FanDuel and DraftKings may continue operating within the state in the interim, Citigroup announced that they would begin blocking DFS debit and credit card payments in the state and payment processor Vantiv announced plans to cease processing payments related to DFS in all jurisdictions by the end of February 2016.

Several pieces of legislation have been proposed in New York concerning the DFS industry, such as legislation to include "fantasy sports gambling" within the definition of "gaming activity" under the New York Racing, Pari-Mutuel Wagering and Breeding Law ("Racing Law") and to give the New York State Gaming Commission jurisdiction over DFS; to remove participation in fantasy sports games from the definition of "contest of chance"; and to effectively deem that DFS is gambling under New York law by amending the New York State Constitution to allow for fantasy sports "wagering" on professional sports (provided such wagering in New York is authorized at the federal level). More recently the Chair of the Senate Racing, Gaming and Wagering Committee proposed a comprehensive bill that would allow DFS operators to register with a new "fantasy sports contests division" within the New York Financial Frauds and Consumer Protection Unit for a \$500,000 fee, impose standards to protect against fraud and problem gambling,

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and tax DFS gross revenues at 15 percent. The bill states that "interactive fantasy sports" are games of skill thus excluding them from the definition of gambling under the New York Penal Law and would allow operators offering DFS prior to November 2015 to continue to operate while their applications for registration were pending.



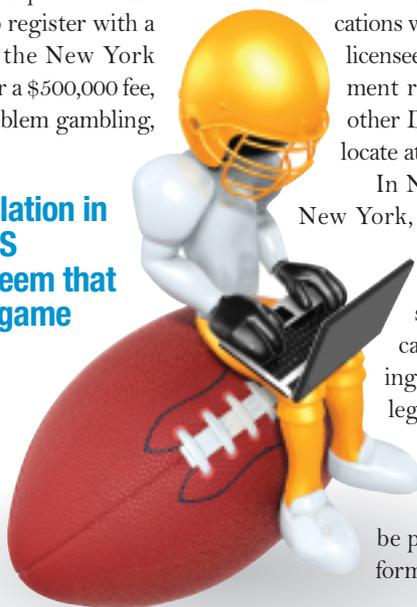
#### IV. New Jersey

New Jersey law criminalizes illegal gambling and the promotion of "gambling." Similar to New York, "gambling" generally requires a wager upon a "contest of chance" or a future contingent event not under the actor's control or influence, and a "contest of chance," in turn, includes contests in which the outcome depends in a material degree upon chance. Accordingly, the status of DFS largely turns on whether DFS outcomes depend, in a material degree, upon chance.

While the New Jersey legislature has yet to pass legislation addressing DFS, in July 2014 the New Jersey Division of Gaming Enforcement ("Division") promulgated a regulation allowing fantasy sports tournaments, provided they are offered by casino licensees and otherwise meet the requirements of UIGEA. The regulation also provides that such tournaments are not considered "gaming" or "gambling" under the New Jersey Casino Control Act and allows casino licensees to partner with third parties to offer such tournaments, provided the third parties are registered as a vendor.

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In New Jersey, as well as other states such as New York, gambling within the state is solely and expressly authorized pursuant to the state constitution. The New Jersey State Constitution, for example, expressly authorizes casino gambling and horse racing. Accordingly, despite proposed legislation from state legislatures and opinions from state attorneys general or state regulators, in New Jersey or New York for example, if DFS constitutes a form of gambling, DFS may still be prohibited unless a referendum is passed formally amending the state constitution.





## VI. Massachusetts

In Massachusetts, where DraftKings is based, the organization and promotion of a “lottery,” defined generally as any activity consisting of prize, chance and consideration, is prohibited, unless conducted within a licensed establishment. Massachusetts courts have traditionally held that a game is considered a lottery if the element of chance predominates over elements of skill. In addition to lotteries, Massachusetts law also prohibits the organization and possession of betting pools “upon the result of a trial or contest of skill . . . .” Notably, as the prohibition on betting pools includes “contests of skill,” it could be argued that the determination as to whether a game is predominantly based on skill or chance is not relevant to culpability in regard to betting pools.

On November 19, 2016, Massachusetts Attorney General Maura Healey proposed DFS regulations primarily focused on consumer protection, including provisions prohibiting minors from participating in DFS, ensuring truthful advertising and placing restrictions on advertising, limiting and securing player deposits, implementing data retention and security measures, addressing problem gambling and ensuring transparency and a level playing field. The proposed regulations also prohibit contests on college sporting events and mandate that DFS operators comply with applicable tax laws.

On January 11, 2016, a day prior to the public comment and hearing on the proposed DFS regulations, the Massachusetts Gaming Commission published a white paper on DFS ultimately recommending new state legislation that would encompass evolving online gaming technologies, including DFS and an “omnibus online gaming regulatory” agency responsible for such gaming, which would have the flexibility to adopt regulations as necessary to accommodate new gaming innovations. The Massachusetts Gaming Commission, however, declined to definitively opine on the legality of DFS and has indicated since October 2015 that the formal regulation of DFS is the responsibility of the Massachusetts Legislature.



## V. Pennsylvania

Under Pennsylvania law, it is unlawful to set up or maintain a device for gambling purposes; solicit or invite any person to visit any unlawful gambling place to gamble; or permit premises to be used for unlawful gambling. Generally, “unlawful gambling” means any gambling that is not specifically authorized under Pennsylvania law, and “gambling” includes any activity involving prize, chance and consideration. If a game is predominantly dependent on chance, even if it is dependent on skill to some degree, it will be considered “gambling.” In short, if the game is considered gambling and is not specifically authorized, it is prohibited under Pennsylvania law.

In May 2015, a bill was proposed to amend the Pennsylvania Race Horse Development and Gaming Act to allow for fantasy sports tournaments. The proposed bill would bring DFS operators under the jurisdiction of the Pennsylvania Gaming Control Board

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(“Board”), and allow the Board to issue “fantasy sports tournament licenses” to casino licensees. The bill requires that fantasy sports tournaments be conducted within a licensed facility and that participants enter into and receive prizes within a licensed facility. Casino licensees would be permitted to partner with “tournament vendors,” who would be required to be licensed and subject to a suitability investigation. Fantasy sports tournament licensees and tournament vendors would be subject to a licensing fee, and licensees would be subject to a 5 percent tax on monthly gross tournament revenue. While the bill is still pending, it has been reported that the bill may be amended, and further, that DFS regulation may be addressed within separate legislation to authorize and regulate Internet gaming within Pennsylvania.

More recently on February 23, 2016, House Bill 941 was signed into law, which mandates that the Board submit a report on DFS to the House Gaming Oversight Committee to provide a definition for “fantasy sports,” address the regulation of fantasy sports in conjunction with existing Pennsylvania gaming law, suggest consumer protection measures, outline mechanisms to facilitate the collection of taxes and provide recommendations for further legislative action in regard to DFS.

## VI. The Future for DFS

Despite the inconsistent approaches concerning DFS on a state-by-state basis, and the continuous and varied regulatory changes facing the industry, a growing number of states are taking steps to monitor, oversee and regulate the industry, and in some cases, tax DFS revenues. With DFS companies allegedly paying out more than one billion dollars in prizes in 2014 and an estimated 56.8 million people in the United States and Canada participating in fantasy sports, the demand for DFS is clear and expanding, and with states constantly seeking new sources of revenue to meet budget shortfalls, the list of states seeking to regulate and tax DFS may continue to grow. ♣



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