



Future of Daily Fantasy Sports: Is DFS “Legal?”

26 July 2016

Points to Consider:



- **Federal Law**

- Several federal statutes at issue, namely the Wire Act, the Illegal Gambling Business Act, the Professional and Amateur Sports Protection Act, and the Unlawful Internet Gambling Enforcement Act.

- **State Law**

- Notwithstanding the federal limitations and proscriptions, States may, via their police powers reserved by the Tenth Amendment, legalize those forms of gambling not expressly prohibited by federal law, including, for purposes of clarity and without limitation, state lotteries, bricks-and-mortar casinos, horse racing, and more recently, internet or online gaming.
- Fold in application of the Commerce Clause, the Supremacy Clause, and the legal doctrine of federal preemption, the net result is an inconsistency and lack of cohesion relative to the laws regulating gambling among the states. Careful attention must be paid to the arguably schizophrenic patchwork quilt of federal, state, and local laws governing the conduct known as gambling; there is a patent inconsistency and lack of cohesion among the laws regulating gambling in our fifty (50) states and the District of Columbia.
- Every state's gambling laws are criminal statutes or, in many cases, express constitutional proscriptions carrying criminal consequences. Gambling products differ: state-conducted lotteries, bricks-and-mortar casinos, horse racing establishments and off-track betting parlors, video-lottery parlors, card rooms, tribal casinos, and more recently, instant racing machines and intra-state internet gaming.

- **Other Considerations: Architecture and Compliance**

- **Room to Grow? Legalized Bridge to Plenary Sports Betting**

Applicable Legal Framework: Federal Law



- **Federal Law**

- ***Anti-Lottery Law***, 18 U.S.C. § § 1301-1304, 1307(a)(1), 1307(b)(1), 1953(a), 1953(b)(4)
- ***Illegal Gambling Business Act***, 18 U.S.C. § 1955
- ***Interstate Transportation of Wagering Paraphernalia Act***, 18 U.S.C. § 1953(a)
- ***Gambling Devices Act***, 15 U.S.C. § 1172(a)
- ***Professional and Amateur Sports Protection Act***, 28 U.S.C. § 3701
- ***Racketeer Influenced and Corrupt Organizations Act***, 18 U.S.C. § § 1961-68
- ***Travel Act***, 18 U.S.C. § 1952(a)
- ***Unlawful Internet Gambling Enforcement Act***, 31 U.S.C. § 5363
- ***Wire Act***, 18 U.S.C. § 1084

Applicable Legal Framework: Federal Law (Cont.)



- **UIGEA, 31 U.S.C. § 5363:**

- Enacted on October 13, 2006 as part of a last-minute add-on to legislation focused on Homeland Security and anti-terrorism measures; advanced in response to a series of illegal gambling schemes that circumvented federal and state gambling and criminal laws. Finding that illegal gambling was being funded primarily through electronic credit and cash-equivalent instruments, Congress consolidated two separate bills with one singular focus – combating illegal Internet gambling activities.
- Prohibits any person in the “business of betting or wagering” from knowingly accepting, “in connection with the participation of another person in unlawful Internet gambling, any proceeds from such activity from . . . an electronic fund transfer, or funds transmitted by or through a money transmitting business . . . from or on behalf of such other person . . . or . . . any other form of financial transaction . . . which involves a financial institution as a payor or financial intermediary on behalf of or for the benefit of such other person.” 31 U.S.C. § 5363(2),(4).
- The term “unlawful Internet gambling” means to “place, receive, or otherwise knowingly transmit a bet or wager by any means” that involves the Internet and violates federal or applicable state law where the bet is “initiated, received, or otherwise made.” § 5362(10)(A).
- Section 5363 prohibits “a person engaged in the business of betting or wagering” from accepting a credit card, bank account, or any other financial instrument for “unlawful Internet gambling.” While this first proscription concerns the use of financial instruments in the context of unlawful Internet gambling, the next provision, Section 5364, directs “each designated payment system, and all participants therein,” to identify and block financial transactions used in furtherance of such unlawful Internet gambling.

Applicable Legal Framework: Federal Law (Cont.)



- **UIGEA, 31 U.S.C. § 5363:**
 - Notwithstanding general prohibitions, carves out from its reach certain intrastate activities, intratribal activities, and horseracing activities.
 - Specifically exempts “fantasy or simulation sports game ... in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team,” from the definition of “bet or wager.”
 - To qualify for the safe harbor, each of the following conditions must be established:
 - no fantasy team is based entirely on the roster of an actual sports team;
 - all prizes and awards are known in advance;
 - the value of the prizes is not determined by the number of participants or the amount of fees paid by those participants;
 - the winning outcome reflects the knowledge and skill of the participants; and
 - no winning outcome is based on the performance of a team, a combination of teams, or on an individual athlete.
 - Some platforms rely upon this safe harbor exemption exclusively for legal justification.

Applicable Legal Framework: Federal Law (Cont.)



- **UIGEA, 31 U.S.C. § 5363:**
 - Contains a rule of construction that limits its scope of applicability
 - *Subparagraph (b) of Section 5361 provides that “no provision of this subchapter shall be construed as altering, limiting, or extending any federal or state law or tribal-state compact, prohibiting, permitting, or regulating gambling.”*
 - Unlike the Wire Act, not a self-contained prohibition; the statute criminalizes only those bets or wagers that are unlawful under applicable federal, state, or tribal law located in the state or tribal lands in which the bet or wager is initiated, received, or otherwise made.
 - In addition to civil remedies, including injunctive relief and the removal of offending websites, UIGEA provides criminal penalties: a violation under UIGEA may result in fines or imprisonment for a period of up to five years.
 - Consequently, no analysis of a contemplated daily fantasy sports contest is complete without an analysis of other key federal and state laws.

Applicable Legal Framework: Federal Law (Cont.)



- **The Wire Act, 18 U.S.C. § 1084:**

- One of most potent weapons utilized by the United States Department of Justice to combat unlawful gambling over the years, the Wire Act. Enacted in 1961, provides in relevant part:
 - Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers **on any sporting event or contest**, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned not more than two years, or both.
- Unlikely Wire Act applies outside the context of a “sporting event or contest.” This is due to the reconciliation of two broad clauses: (1) the statutory prohibition of persons engaged in “the business of betting or wagering” from knowingly using a wire communication facility to transmit such bets or wagers (or information to assist in the placing of bets or wagers) “in interstate or foreign commerce” on “any sporting event or contest;” and (2) the statutory prohibition of the knowing use of a wire communication facility to relay information that would result in the receipt of “money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers.”
- Without a compelling public policy reason or legislative mandate for such disparate applications of the statute, the most reasonable interpretation limits the scope of the Wire Act to apply to only “sporting events or contests.” Two clauses must be reconciled: if “any sporting event or contest” applied only to such “information assisting in the placing of bets or wagers,” then the Wire Act would forbid the transmission of bets or wagers in interstate or foreign commerce on all types of offerings, including lottery and casino-style games, yet would only prohibit the transmission of assisting information in the context of sporting events.

Applicable Legal Framework: Federal Law (Cont.)



- **The Wire Act, 18 U.S.C. § 1084:**

- Unlike other federal anti-gambling statutes, Wire Act does not expressly require that gambling business be operating illegally under applicable state law; this statute does not require a predicate violation of state law in order to trigger liability.
- Instead the Wire Act, which applies to interstate communications, exempts communications from a jurisdiction where the gambling activity is lawful to another jurisdiction where the same activity is lawful. 18 U.S.C. § 1084(b).
- By contrast, UIGEA's intrastate exemption contains an exception designed to facilitate licensed intrastate gaming. That exception provides that "the intermediate routing of electronic data shall not determine the location or locations in which a bet or wager is initiated, received, or otherwise made." 31 U.S.C. § 5362(10)(E).
- This provision clarifies that an otherwise lawful wager is not rendered unlawful under UIGEA merely because data may cross jurisdictional boundaries in the course of facilitating a transaction. Thus, for example, the purchase of a lottery ticket from a mobile device in New York -- routed through a data network in Virginia and ultimately received by the New York State Lottery -- would not be rendered unlawful under UIGEA merely because the data was transmitted across state lines.
- This interpretation is consistent with the Memorandum Opinion issued by the DOJ in December of 2011. In addition, in a letter to Majority Leader Sen. Harry Reid, the DOJ's Office of Legislative Affairs affirmed that "the Wire Act only applies to the transmission of bets or information assisting in the placing of bets or wagers relating to sporting events or contests."
- Consequently, no analysis of a contemplated daily fantasy sports contest is complete without an analysis of other key federal and state laws.

Applicable Legal Framework: Federal Law (Cont.)



- **PASPA, 12 U.S.C. § 3701:**

- Enacted in 1992 in response to concern over state sponsored sports gambling. In pertinent part, makes it illegal for any private person to operate a wagering scheme based on a competitive game in “which professional or amateur athletes participate.” 28 U.S.C. § 3702(2).
- Effectively outlawed the further proliferation of sports betting nationwide, with the exception of four states where a sports betting scheme had already been established (Delaware, Montana, Nevada, and Oregon). Section 3704 “grandfathered in” those lawful sports gambling schemes and provided one year from PASPA’s effective date for states that had operated licensed casino gaming for the previous ten-year period (i.e., New Jersey) to pass laws permitting sports wagering. No other state exercised such right.
- Section 3702 provides it is unlawful for:
 - a governmental entity to sponsor, operate, advertise, promote, license, or authorize by law or compact, or a person to sponsor, operate, advertise, or promote, pursuant to the law or compact of a governmental entity,
 - a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly (through the use of geographical references or otherwise), on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, or on one or more performances of such athletes in such games.
- Section 3702 provides for a private right of action, authorizing not only the United States Attorney General to seek injunctive relief, but also any professional or amateur sports organization who may be impacted by a violation of Section 3702.

Applicable Legal Framework: State Law



- No analysis of a contemplated daily fantasy sports contest is complete without an analysis of state laws. UIGEA's covalent bond to other laws, an analysis of the legality of any daily fantasy sports contest demands an appreciation of each state's definition of "gambling" and the criminal proscriptions ascribed to "unlawful gambling" where the state has not yet passed legislation specific to daily fantasy sports.
- Each of our fifty (50) states has legislated its own independent definition of "gambling" as well as the legal elements to said definitions, creating a patch-work quilt of gambling enforcement and regulation.
- Every state's gambling laws are criminal statutes or, in many cases, express constitutional proscriptions carrying criminal consequences.
- Moreover, each state's gambling product differs: state-conducted lotteries, bricks-and-mortar casinos, horse racing establishments and off-track betting parlors, video-lottery parlors, card rooms, tribal casinos, and more recently, instant racing machines and intra-state internet gaming.
- It is because of this colorful panoply of gambling offerings that state policies differ from state to state. And with principles of federalism and Tenth Amendment doctrine imposing an obligation upon the states to adopt their own laws concerning gambling, there is a patent inconsistency and lack of cohesion among the laws regulating gambling in our fifty (50) states and the District of Columbia.

Applicable Legal Framework: State Law (Cont.)



- However, inconsistent gambling product-mix, regulation, and enforcement may be among the states; the majority of the states do adopt the traditional definition of gambling, consisting largely of three elements: **Prize**, **Chance**, and **Consideration**.
- Such is more of an iconic bond, as the methodology to determine the existence of each such legal element differs widely from state to state. Possible reasons for such disparity: the social acceptance of a specific form of gambling in one geographical location, the need for economic traction derived from such activities, or the moral absolutism against all forms of gambling. State policies fluctuate relative to the definition of unlawful gambling, and, in recognition of such variety, states have even employed different approaches to defining the legal element known as “chance.”
- In the absence of express statutory authority governing fantasy sports, we look to specific tests and the aggravating or mitigating factors in the regional gambling climate generally to measure the level of risk afforded to a daily fantasy sports contest under each state’s laws. Several tests in gambling law jurisprudence, each of which attempts to marry a parochial quantum of chance with an often subjective act to determine the existence of a “gambling game:”
 - “**Predominance Test**”;
 - “**Material Element Test**”;
 - “**Any Chance Test**”; and
 - Rarely used “**Gambling Instinct Test**”.

Applicable Legal Framework: Predominance Test



- Courts evaluate whether chance predominates over skill in a particular game. In finding electronic poker machines to be games of chance and, therefore, prohibited by state law, the Supreme Court of Pennsylvania described the predominance test as follows:
 - *While skill...can improve a player's chances of winning and can maximize the size of the winnings, chance ultimately determines the outcome...in short, a large random element is always present. That the skill involved in Electro-Sport is not the same skill which can indeed determine the outcome in a game of poker between human players can be appreciated when it is realized that holding, folding, bluffing and raising have no role to play in Electro-Sport poker. Skill can improve the outcome in Electro-Sport; it cannot determine it.*

Commonwealth v. Two Electronic Poker Game Machines, 502 Pa. 186, 196 (1983).
- Similarly, the North Carolina Court of Appeals held: “[W]hile all games have elements of chance, games which can be determined by superior skill are not games of chance. For example, bowling, chess, and billiards are games of skill because skill determines the outcome. The game itself is static and the only factor separating the players is their relative skill levels. In short, the instrumentality for victory is in each player's hands and his fortunes will be determined by how skillfully he use that instrumentality.” Joker Club, LLC v. Hardin, 183 N.C. App. 92, 98 (Ct. App. 2007) (affirming the lower court’s finding that poker is a game of chance).

Applicable Legal Framework: Predominance Test (Cont.)



- While risk exists because it is unknown whether a finder of fact in the jurisdictions applying the predominance test would determine that fantasy sports constitute a game of skill, a “predominance” of skill may be found where the skill employed is greater than any element of chance present. “Although chance inevitably intervenes, it is not inherent in the game and does not overcome skill, and the player maintains the opportunity to defeat chance with superior skill.” Joker Club, 183 N.C. at 99. The argument behind the legality of contests similar to the Offering is that one’s command of statistics, knowledge of the game, and close observation of a number of factors affecting performance are all matters of skill – not luck – and it is because of the predominance of skill in the Offering that there exists low risk that a finder of fact in these jurisdictions may find such a contest to be a game of chance and, consequently, unlawful.

Applicable Legal Framework: Material Element Test



- A more subjective methodology than the predominance test. This test demands a subjective quantification of chance, usually determined by a government official. The amount of chance considered “material” is a fact-sensitive inquiry, and it is therefore, hard to delineate where skill ends and chance begins. Cases interpreting the material element test do not identify a materiality threshold, leaving the decision to the fact-finder to decide what a reasonably prudent person would consider to be “material.”
- Holding that poker and blackjack are games of chance due to the fact “the outcome depends to a material degree” on the cards dealt, a New York court noted that while a player’s skill “may increase the odds in the player’s favor, [it] cannot determine the outcome regardless of the degree of skill employed.” People v. Turner, 629 N.Y.S.2d 661, 662 (N.Y.C. Crim. Ct. 1995).
- Standard is subjective, and the jurisprudence does not define a threshold quantifying the amount of chance needed to trigger a finding of materiality. Jurisdictions employing this test usually are dependent upon other factors.

Applicable Legal Framework: Any Chance Test



- Sets a relatively low threshold as to the quantum of chance needed to constitute a gambling game. In these jurisdictions, unlikely that any game, no matter how much skill is employed, is completely devoid of chance.

- *The outcome is always determined by chance because no player, through the exercise of skill alone, can control the outcome of any given trial. It is chance that finally determines the outcome of each and every trial. Thus, it is the incorporation of chance that is the essential element of a gambling device, not the incorporation of a particular proportion of chance and skill.*

State v. Gambling Device, 859 S.W.2d 519, 523 (Tex. App. 1993) (holding that the definition of a gambling device does not require a “quantitative comparison of the respective proportions of chance and skill”).

- *Regardless of how much skill may precede the race or fight, it is the chance or luck that an underdog may prevail that encourages the betting public.*

Fall v. Commonwealth, 245 S.W.3d 812, 814 (Ky. Ct. App. 2008) (holding a cockfight constituted gambling under the statute because it requires only the “element of chance” ...”).

- In these jurisdictions, any presence of chance is all that is required to classify a contest as unlawful activity. States employing the “any chance” test are considered “high risk” due to the relatively low threshold of chance needed to establish a game of chance and, therefore, an unlawful activity.

Other Considerations: Architecture and Compliance



- A minority of states have affirmatively legislated such activity, and the trend appears to be directed towards legalization. Other areas requiring consideration:
 - **General Corporate/Organizational:** An entity considering offering a daily fantasy sports contest should pay meticulous attention to the actions and recorded minutes of its Board of Directors. For example, company minutes and resolutions should demonstrate that the Board conducted appropriate due diligence and has formally addressed the legality of daily fantasy sports or at least questioned the legal viability of any contemplated daily fantasy sports offering, including, securing an outside legal opinion, memorandum or other position paper illustrating the legal position of such entity.
 - **Compliance Committee/Internal Controls:** An entity considering offering a daily fantasy sports contest should have an internal audit committee, or another organizational arm that is actively questioning or ensuring the present and future legal viability of the business model. In addition, any such entity should develop and enforce internal controls or operating procedures outside of any software programming or coding; such controls are critical to the auditability of financials and/or operations.
 - **Offering/Game Mechanics:** In addition to any specific regulations prescribed by states affirmatively permitting daily fantasy sports contests, entities should be very cautious of “Head to Head” contests or “Non-Guaranteed” offerings with limited professional events, as such presented in both the optics of the offering and actual game design.

Other Considerations: Architecture and Compliance



- **AML, KYC, and Age-Gates.** Beginning stages of engaging vendors to assist with geofencing, age verification, and other critical “Know-Your-Customer” procedures. Current KYC processes are limited, which increases the risk of play by participants not of legal age or located in high risk jurisdictions. For example, the current age and geolocation controls provided by the Company largely rely upon internal processes, e.g., the Company requests copies of ID and payment methods after players exceed internal deposit and withdrawal thresholds “or if there is a reason to suspect a minor is creating the account.” Furthermore, Company utilizes “internet searches, social media searches, and LexisNexis to authenticate user information.”
- **Advertising / Consumer Protection.** Various marketing and advertising collateral raises questions regarding the product and services offered and the manner in which such are offered and in which markets such are offered. Material risks both in terms of bad content and wrong jurisdiction (e.g., Lincoln Tunnel).
- **Financials.** An entity offering any daily fantasy sports contest should be able to demonstrate that there is no affirmative connection between prize amounts and the number of participants.
- **Terms of Use / Representations and Warranties.** Any website controlled by an entity offering a daily fantasy sports contest should avoid any representations that the contemplated offering is “100% legal.” In addition, any terms of use should be accurate with respect to cancellation rates between different games and promotional/marketing credits (if applicable).



RESOURCES NEEDED TO GROW:

- Trending Towards Legalization; Legislative Outreach
- Continue Growing Social Acceptance
- Avoid Unnecessary Political Exposure
- Consider Value-Add Strategic Alignments

QUESTIONS?

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