

Daily Fantasy Sports: A Regulatory Dilemma Worth Resolving

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When (“if” can no longer be fairly used) the Daily Fantasy Sports industry becomes regulated, Ethan Haskell, a content manager for DraftKings who earned \$350,000 in one FanDuel contest after posting information that appeared to give him a competitive advantage, will be a central figure of the regulatory origin story. Following his “insider trading” incident in September 2015, many state and federal regulators began considering whether daily fantasy sports constitute gambling and whether it can be regulated.

DraftKings and FanDuel are the two biggest players in an estimated \$3.1 billion industry that put on contests (they say of “skill”) where participants pay to select actual players in a wide variety of sports (baseball, basketball, football, etc.) to compete in a one-day league or directly against another team. The daily outcomes are based upon real sporting results, with winners earning (sometimes) thousands in prize money, and losers often resetting to play the next day. The industry has built its near-billion dollar business by associating with the National Basketball Association, the National Hockey League, Major League Baseball and the National Football League. While some of the professional sports leagues may be rethinking these relationships in light of increased scrutiny, every daily fantasy sports site is evaluating its model going forward. In so doing, the industry and regulators are in a classic dilemma -- a difficult choice must be made between two or more (potentially undesirable) alternatives.

The Exclusion That Launched A Thousand (And Likely More) Leagues

At the federal level, the Unlawful Internet Gambling Enforcement Act of 2006 (“UIGEA”) (which was part of homeland security legislation) prohibits web-based payments for illegal bets and makes transactions from banks or similar institutions to online gambling sites illegal. However, the UIGEA excludes:

(ix) participation in any fantasy or simulation sports game or educational game or contest 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 that is a member of an amateur or professional sports organization (as those terms are defined in section 3701 of title 28) and that meets the following conditions:

(I) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(II) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(III) No winning outcome is based—

(aa) on the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams; or

(bb) solely on any single performance of an individual athlete in any single real-world sporting or other event.

31 U.S.C. § 5362(1)(E)(ix).

The industry relies on this specific provision of the UIGEA to establish the legality of its business and to “prove” daily fantasy sports are games of skill, not gambling. Of particular importance, under the heading of “Interstate horseracing,” 31 U.S.C. § 5361(10)(D) contains the only mention of the preemption prohibition, providing that “[n]othing in this subchapter may be construed to preempt any State law prohibiting gambling.” This begs the critical question of whether this preemption prohibition only applies to “Interstate horseracing” (which is subject to the Interstate Horseracing Act of 1978) or if it applies to state efforts to regulate daily fantasy sports leagues.

Are Such Efforts to Regulate on the State Level Legal?

With respect to state efforts, though new states are being added to the list, as of the writing of this article, daily fantasy sports leagues are considered illegal in 11 states. Some states, like New York and Texas, assert that daily fantasy sports leagues violate state gambling laws, while Nevada asserts that such sites cannot operate without a gambling license. In at least 16 other states, government entities are either reviewing the legality of such activities or are seeking to further clarify the law and/or to allow daily fantasy sports to continue with additional oversight. The rest of the states have either expressly made daily fantasy sports legal or have not addressed the issue.¹

However, rather than analyze what states are doing, we should first ask what they can actually do. The Professional and Amateur Sports Protection Act of 1992 (PASPA)², which is focused on prohibiting state-regulated sports betting on the outcomes of professional and amateur sporting events, makes clear under the heading of “Unlawful Sports Gambling” that:

It shall be unlawful for --

(1) a governmental entity to sponsor, operate, advertise, promote, license, or authorize by law or compact, or

(2) 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 geographic reference 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.

28 U.S.C. §3702.

Accordingly, the PASPA plainly prohibits a “governmental entity” from sponsoring, operating or promoting any betting or wagering scheme based directly or indirectly on the performance of an athlete or group of athletes in games in which amateur or professional athletes participate. As daily fantasy sports leagues are certainly based upon individual performances, the question becomes whether states can legalize or regulate daily fantasy sports leagues as such activity, based upon the plain language of the statute, is prohibited sponsorship, operation, and/or promotion of a betting or wagering scheme. Thus, per PASPA, state efforts with respect daily fantasy sports leagues are likely in a binary state – they can be banned, but not legalized or regulated.

¹ For a complete census of state of daily fantasy sports efforts across the country, review the Legal Sports Report compilation at <http://www.legalsportsreport.com/daily-fantasy-sports-blocked-allowed-states/>.

² Four states are exempted from PASPA: Delaware, Montana, Nevada and Oregon and (1) Montana already operates fantasy sports through its state lottery; (2) Delaware only writes NFL parlay cards though, citing its exemption, has attempted to establish sports betting but was stymied by a 2009 decision ruling that Delaware could only offer the same type of betting it did before PASPA was enacted; (3) Nevada has the ability to legalize nearly any form of sports betting; and (4) Oregon’s sports betting was similar to Delaware’s, except that it has also spread NBA parlays. Oregon, however has not reentered the sports betting market since its Sports Action lottery ceased after the 2006 NFL season.

Payment Processors As De Facto Regulators?

However, a different obstacle may be much more difficult to overcome: payment processors refusing to facilitate daily fantasy sports league transactions. Vantiv Entertainment Solutions, a credit card payment processing company, recently informed its daily fantasy clients that it would suspend processing all daily fantasy sports payment transactions as of February 29, 2016 because, while acknowledging arguments to the contrary, many state attorney generals have determined that daily fantasy sports sites participate in illegal gambling.³

Per the New York Times, many legal experts cite the UIGEA, which, again, specifically excludes fantasy sports from its purview as their “outcomes reflect the relative knowledge and skill of the participants,” as requiring payment processors like Vantiv to prohibit transactions when a state says that a sports website is offering gambling services. However, the New York Times (citing Vantiv’s letter to customers) reported that Vantiv has made clear that as “payments experts in the online gaming space, Vantiv will continue to work with stakeholders for a long-term solution to the ongoing [daily fantasy sports] controversy. When there is better clarity and long-term certainty around the regulatory and judicial landscape related to [daily fantasy sports], Vantiv may decide to resume processing these types of payment transactions.”

If other payment processors follow Vantiv’s example (and Vantiv is a leader in the payment processing industry) the question of how the industry is regulated will become moot because, without a convenient form of payment, many players will not participate. However, some more cynical experts might think that payment processors are looking into alternative payment systems so they can take higher fees to reflect increased risk; akin to a virtual “rake.” Again, payment processors are placed in a legal dilemma: choosing between lucrative daily fantasy sports payment fees and bowing to regulatory efforts that may, or may not, be preempted. Vantiv has already made its choice, and others may follow.

A Proposed Framework for Resolution

In resolving these various legal dilemmas, a clear path of choices has emerged:

First, the question of whether the UIGEA preempts states from regulating daily fantasy sports must be conclusively resolved. Again, broad preemption language exists, but its deliberate placement in the statute under a specific sub-section, separate from the one addressing daily fantasy sports, indicates that state regulation of daily fantasy sports leagues is preempted.

Next, if the UIGEA does not preempt state regulation, does PASPA require that the states can only choose between banning daily fantasy sports league or doing nothing? And who will police the daily fantasy leagues to ensure that they are operating fairly so “insider trading” and other abuses do not occur while ensuring a byzantine, multi-participant, regulatory scheme governing mostly interstate transactions does not reign?

Finally, if regulations are not preempted, and certain states can ban daily fantasy sports activity, how can payment processors legally facilitate payments? Based upon Vantiv’s assertion, payment alternatives are being considered, but how will they evolve? Will each daily fantasy sports league offer different tokens, like casinos offer chips?

In resolving these issues, the most logical path would be to first determine that the UIGEA preempts state regulation; especially since PASPA requires a Hobson’s choice of banning daily fantasy sports leagues or not, a choice that seems unworkable given the popularity of such daily fantasy sports leagues. Then the Federal Trade Commission (“FTC”) – the only regulator with the dual mission to protect consumers and promote competition – should be charged with monitoring business practices and reviewing industry consolidation. Such a resolution allows a competitive daily fantasy sports industry to exist, while still ensuring that potential unfair, abusive, and/or deceptive practices are policed. This is also an optimal scheme because the FTC has become the country’s primary cyber-regulator, critical for any entity charged with regulating on-line industries.

Regardless of how these dilemmas are resolved, considering the state of the law, the popularity of fantasy sports, and the sheer size of the industry, the predicted demise of daily fantasy sports is likely overstated.

³ “Payment Processor to Stop Working With Daily Fantasy Sports Clients,” New York Time, January 29, 2016 (<http://www.nytimes.com/2016/01/30/sports/draftkings-fanduel-vantiv-daily-fantasy.html>).