SPEECH: THE LEGAL STATUS OF DAILY FANTASY SPORTS IN A CHANGING BUSINESS ENVIRONMENT

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I. INTRODUCTION

Nearly four years ago when I wrote my Harvard law journal article A Short Treatise on Fantasy Sports and the Law, more than 95 percent of the article related to traditional, full season fantasy sports contests. Of course, there were a few paragraphs discussing “daily fantasy sports.” However, at the time, “daily fantasy sports” represented just a small, and perhaps aberrant, segment of the overall fantasy sports marketplace. Major League Baseball Advanced Media CEO Robert Bowman even referred to “daily fantasy sports” as “akin to a flip of the coin, which is the definition of gambling.”

Since then, a lot has changed. Today, Major League Baseball has backed away from Robert Bowman’s earlier comments about “daily fantasy sports” being “akin to a flip of a coin” and now it even partners with a daily fantasy sports website. Meanwhile, this past November, the National Basketball Association became a shareholder in FanDuel: the largest daily fantasy sports website in the country.

Today, I am going to discuss how the United States has moved in such a short period of time from an era where these one-day fantasy sports contests had been seen as similar to illegal sports gambling into an era in which one cannot turn on a television set to ESPN without seeing commercials for one-day fantasy sports leagues. I am also going to discuss my perceptions of the legality of “daily fantasy sports” under both state and federal law. As I will explain throughout my presentation, the legality of “daily fantasy sports” indeed is not a one-size-fits-all

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2. See id.


solution. Rather, whether a given fantasy sports contest is legal depends on the individual contest’s game rules and states of operation.

II. THE HISTORY OF “FANTASY SPORTS”

Before we get into the subtleties of federal and state gaming law, it may be helpful to provide a backdrop about the history of fantasy sports and how these contests operate. As some in attendance may know, fantasy sports has a very rich, innovative and surprisingly academic tradition. The earliest versions of fantasy sports began at Harvard University in the form of a game known as “The Baseball Seminar.” Professor William Gamson called his contest a “seminar” because he did not want his colleagues to know what he was really doing in his spare time.

Ultimately, Gamson’s academic career took him from Harvard University to the University of Michigan, and he brought the Baseball Seminar with him to Ann Arbor, MI. At the University of Michigan, one of the other professors who participated in Gamson’s annual contest was a journalism and film studies professor, Robert Sklar. Thereafter, Sklar introduced the game to his mentee, Dan Okrent, who later moved to New York and became a reporter for The New York Times.

Although Gamson’s original contest remained a private pursuit, it was Okrent’s version of “the Baseball Seminar” that captured widespread media attention. Okrent and his friends got together each year to select players for their game at Manhattan’s now-defunct French restaurant, La Rotisserie Francaise. There, each participant posted a $260 entry fee to bid on players from Major League Baseball’s National League. At season’s end, the teams were ranked based on four pitching statistics and four hitting statistics, and the teams that earned the most total points received cash prizes.

Over the next decade, Okrent’s version of “the Baseball Seminar,” which ultimately was renamed “Rotisserie Baseball,” gained national attention and somewhat of a cult following. Then in 1994, “the Internet came along and changed everything.” That year marked the first time that common Americans

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6. See Edelman, supra note 2, at 5-11 (discussing the early history of fantasy sports).
7. See id. at 5-6.
8. See id. at 6, n. 21 (explaining that the term “seminar” was used to reduce any association between the game and illegal gambling).
9. See id. at 6.
10. See id.
11. See id.
13. See id. at 6.
14. See id. at 7-8.
15. Id. at 7.
16. Id. at 10.
began to have Internet access in their homes. Of course, it was a slow, dial-up version of the Internet that people logged onto using software such as CompuServe, Prodigy, and America Online. But even with this early version of home Internet, it became possible for sports fans around the country to enter into fantasy sports leagues against one another. Thus, what began as a hobby with a mere cult following began to garner broader interest.

By 1995, several sports media companies had begun to offer fantasy sports on the Internet. These sports media companies recognized that they could very easily bring together sports fans from around the world and provide statistical upkeep services for fantasy leagues. In the case of companies such as CBS Sportsline, they also recognized they could collect entry fees and payout prizes in fantasy sports contests: tasks that were very enticing to fantasy sports participants that felt more comfortable with an established company holding their money.

However, right around the same time that fantasy sports was booming on the Internet, online sports gambling and online poker websites were also booming: developments that were causing major concern for some regulators. In fact, by right around the start of 2000, several studies were showing that college students that had fulltime access to the Internet were betting regularly on the results of sporting events from all types of online sports books, many of which were located outside of the United States. The sports leagues were up in arms about the emergence of these sports books; they wanted them shut down. But they did not want anything to happen to fantasy sports: an activity that the leagues were beginning to recognize added interest into their games and provided revenues to many of their broadcast partners.

In 2006, Congress passed the Unlawful Internet Gambling Enforcement Act, which for the first time gave the U.S. Department of Justice power to come after the payment processors for funding illegal forms of gambling. However, at the request of the commercial sports lobby, the act included a narrow carve-out that insulated payment processors from liability if they funded certain forms of activities that were declared as “fantasy sports.”

17. Id.
20. See Sam Borden, Online and On Campus, N.Y. DAILY NEWS, Apr. 14, 2002, at 93, available at 2002 WLNR 13840260 (explaining that online sports betting had become a regular part of some college students’ day-to-day lives).
22. Id. § 5362(1)(E)(ix).
III. FROM “FANTASY SPORTS” TO “DAILY FANTASY SPORTS”

Fast forward now to 2007 – one year after Congress introduced the Unlawful Internet Gambling Enforcement Act (“UIGEA”) and its narrow fantasy sports carve-out. A frustrated poker blogger out in California, Kevin Bonnett, believed that he had found a loophole in the law that would make him extremely wealthy. Bonnett wanted to bring back something that looked like casino sports gambling on the web, but he knew if he did so in the traditional manner he would probably get indicted under the UIGEA. So, Bonnett created something that looked just like a sports casino, but instead of picking teams to win, entrants would pick individual players that they believed would perform well over a single day.23 Bonnett then coined the term “daily fantasy sports” to describe his new website, purporting that the contest was the type of fantasy sports game that fell within the federal carve-out stipulated under the Unlawful Internet Gambling Enforcement Act.24

At first nobody gave Kevin Bonnett’s FantasySportsLive website much attention. In fact Kevin Bonnett’s FantasySportsLive.com was out of business within just a few years. He targeted the poker community. The mainstream community did not really play because they thought there were legal issues with it.25 But, Kevin Bonnett’s short-lived website never got challenged under federal law, and he also never got challenged under state law.

The fact that Kevin Bonnett did not face any legal action for his “daily fantasy sports” game led others to enter the marketplace, even as FantasySportsLive failed to thrive as a business venture. Another “daily fantasy sports” company called Snapdraft launched in fall 2008.26 Meanwhile, a company called Fantasy Factor launched sometime in 2009.27 And a group of Scottish entrepreneurs with ties to McKinsey Consulting’s gaming group launched a “daily fantasy sports” company in mid-2009 called FanDuel.28

23. See generally KEVIN BONNETT, ESSENTIAL STRATEGIES FOR WINNING AT DAILY FANTASY SPORTS Kindle Location 219 (Kindle ed.) (2014) (explaining that the author’s launch of the purportedly first daily fantasy sports game was done more with a focus on traditional sports gambling and poker strategies than on fantasy sports strategies).
24. See id.
25. See Oskar Garcia, Daily Fantasy Sports Become a Gambling Reality, ASSOCIATED PRESS (Sept. 24, 2010), available at http://sports.yahoo.com/top/news(slug=txgamblingfantasy sport (quoting Fantasy Sports Trade Association founder Paul Charchian as admitted that the legal status of daily fantasy sports has “always been a little murky” and “a lot of companies didn’t have the stomach for it.”).
26. See id. (purporting that Snapdraft was first launched on the Fanball website in 2008).
Ultimately, FanDuel became the clear market leader in “daily fantasy sports” by taking the exact same business model as Kevin Bonnett but finding a way to partner with more established and societally accepted companies. Much like Kevin Bonnett’s venture, FanDuel did not face any criminal challenges. In time, some very powerful entrepreneurs in the private equity space took the lack of criminal challenges as a sign to invest in the “daily fantasy sports” marketplace, and especially FanDuel. By 2013 FanDuel began to accept funding from large equity companies such as NBC Comcast, KKR, and Shamrock Investments. By fall 2014, FanDuel even convinced the National Basketball Association to become investors in their business.

IV. IS “DAILY FANTASY SPORTS” LEGAL?

Most sports fans know that there is a growing interest in “daily fantasy sports.” But the more interesting question, of course, is whether these “daily fantasy sports” contests are truly legal. As a matter of state law, just about every state recognizes that an activity would constitute a form of illegal gambling if three elements are met: consideration (this generally means an entry fee); reward (this generally means a prize), and chance. Because most daily fantasy sports contests include entry fees and prizes, these contests will be deemed illegal under state law if they are found to be “games of chance.” By contrast, they will be found legal if they are “games of skill.”

Now that all sounds nice and simple. But the major caveat to that is every state defines the element of chance differently. Thus a particular “daily fantasy sports” contest may be a game of skill in one state, but not another. Furthermore, within a given state some existing contests may be deemed games of skill, while others may be deemed games of chance.

30. See generally Brustein, supra note 4.
31. See Paresh Dave, Betting on Speed, L.A. TIMES, Jul. 12, 2013, at 1; see also Kyle Alspach, Techstars Grad StarStreet Reports $1.4 M Fundraise, BOS. BUSINESS JOURNAL, Aug. 28, 2013, available at 2013 WLNR 21429861 (discussing $1.4 million in private equity funding raised by daily fantasy sports startup, StarStreet).
32. See Justin Tasch, Fantasy Boom: With Daily Leagues for Big Bucks, Tournaments Paying Out Millions & its Own Network, Fantasy Sports in Blowing Up, N.Y. DAILY NEWS, Nov. 9, 2014 (discussing private equity funding for both FanDuel and DraftKings).
33. See Ken Belson, Will Other Leagues Join the NBA? Don’t Bet on It, N.Y. TIMES, Nov. 15, 2014, at D1 (discussing the NBA’s equity stake in FanDuel); see also Edelman, supra note 6 (discussing the legal and strategic business risks that come along with the NBA’s investment in FanDuel).
34. See Edelman, supra note 2, at 26-29.
35. Id. at 26-27.
On one end of the spectrum, the most favorable set of states for operating “daily fantasy sports” contests are known as “predominant purpose test states.” At the other end of the spectrum, there are “any chance states,” where contests that involve at least some degree of chance are illegal. “Any chance states” include not only states such as Arizona, Louisiana and Iowa where FanDuel and DraftKings currently block players under their terms of service, but also several states in which the largest “daily fantasy sports” contests operate, including, for example, Tennessee, Arkansas and perhaps a few others. Meanwhile, there are also a number of states that apply middle ground tests such as “material element” tests. These states allow contests with some chance, but only a small amount.

Proving that a given “daily fantasy sports” contest meets the threshold requirements for “skill” in any given state, and under any particular test, is rather challenging. Even under the predominant purpose test, the providers of “daily fantasy sports” contests would still need to devise a way to prove their contest involves more skill than chance. There is no single, clear-cut way of doing this. I have seen some “daily fantasy sports” contests try to say “we have consistent winners.” But consistent winners is not necessarily enough to prove a contest is driven primarily by skill.

36. See id. at 29 (“A majority of states adopt … the ‘predominant purpose test’ as the measure of chance.”).

37. See O’Brien v. Scott, 89 A.2d 280, 283 (N.J. Super. Ct. Ch. Div. 1952) (explaining that under New Jersey’s application of the predominant purpose test, “[t]he test of the character of the game is, not whether it contains an element of chance or an element of skill, but which is the dominating element that determines the result of the game, or, alternatively, whether or not the element of chance is present in such a manner as to thwart the exercise of skill or judgment”).

38. See Edelman, supra note 2, at 31-32 (discussing the “any chance” states).

39. See ARIZ. REV. STAT. ANN. § 13-301(4) (2014) (defining illegal gambling as “risking or giving something of value for the opportunity to obtain a benefit from a game or contest of chance or skill or a future contingent event but does not include bona fide business transactions which are valid under the law of contracts including contracts for the purchase or sale at a future date of securities or commodities, contracts of indemnity or guarantee and life, health or accident insurance”) (emphasis added); State v. Torres, 831 S.W.2d 903, 905 (Ark. 1992); Parker-Gordon Importing Co. v. Benakis, 238 N.W. 611, 613 (Iowa 1931) (noting that Iowa finds it irrelevant whether a particular game is predominantly based on chance or skill); TENN. CODE ANN. § 39-17-501 (2010) (defining “gambling,” subject to a number of generally irrelevant exceptions to fantasy sports, as “risking anything of value for a profit whose return is to any degree contingent on chance”).

40. See Peter v. Turner, 629 N.Y.S. 2d 661, 662 (N.Y. Crim. Ct. 1995) (“Gambling differs from other kinds of contests in that in gambling ‘the outcome depends in a material degree upon an element of chance, notwithstanding that skill of the contestants may also be a factor therein’.

41. See, e.g., Thole v. Westfall, 682 S.W.2d 33, 37, n. 8 (Mo. 1984) (explaining that under Missouri’s version of the material element test, for a contest to be illegal “chance must be a material element in determining the outcome of a gambling game,” but “[i]t need not be the dominant element”).
Let me explain why that is the case through an example involving another industry: the bond trading industry. Bill Gross is a very famous bond trader. He beat the bond market for fifteen consecutive years. But what we do not know for sure is whether Bill Gross beat the market because he is an incredibly skilled bond trader or whether Bill Gross was just the lucky one out of 32,768 traders that the law of averages indicates is likely to do just that.

To explain this mathematically, one out of two people beat the bond market on any given year, so there’s about a half a chance – a 50 percent chance – that any given bond trader will beat the market on a given year. Thus, the probability of any individual beating the bond market by chance for fifteen consecutive years is roughly one over two to the fifteenth power. Consequently, if there are 32,768 bond traders in the U.S. who trade for a fifteen-year period, odds indicate that at least one of them – even if they all pick randomly – would beat the market all fifteen years. Thus, there is no reason to know if Bill Gross was just that lucky random picker, or if there was something more to it.

Now, back to “daily fantasy sports.” Of course, there are going to be some repeat winners the same way there will likely always be some bond trader who beats the market fifteen years running, or some lottery player who hits the jackpot twice in her lifetime. But proving that a contest is one of skill takes more than that. In the question and answer session that follows, I would love to speak more about what “daily fantasy sports” games can do to maximize the level of skill and minimize the level of chance in their contests. Developing strategies to maximize levels of skill and minimize elements of chance is going to be an important topic for the largest contests in trying to maximize their likelihood of legality under both federal and state gaming law, and it is a topic that I will discuss extensively in my upcoming January 2016 law review article in the UNIVERSITY OF ILLINOIS LAW REVIEW, Navigating the Legal Risks of Daily Fantasy Sports. But, for now, I will end discussion of this particular issue and turn to a brief discussion of federal law.

Indeed, beyond state law concerns, all “daily fantasy sports” contests also must comply with applicable federal laws. There is not sufficient time in this speech to discuss all applicable federal laws here. But, greatly oversimplified, the federal legal requirements for contests such as “daily fantasy sports” largely conflate with the aforementioned state requirements because, to comply with federal law, contests still must be deemed games of skill in all states of operation. Of important note is that

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the newest federal law – the Unlawful Internet Gambling Enforcement Act of 2006 – includes a special carve-out that makes it safer for payment processors to fund certain businesses that might otherwise fall within the scope of the act.45 Included within this carve-out is “any fantasy or simulation sports game or educational game or contest in which … no fantasy or simulation sports team is based on the current membership of an actual team,” and three important requirements are met: (1) all winning outcomes are based on the relative skill and knowledge of the participants; (2) all prize amounts are made known before the contest begins; and (3) no winning outcome is based on the scores or performance of a single-real world event or the performance of any real world team.46

Given that the Unlawful Internet Gambling Enforcement Act and this carve-out became law in 2006 – one year before the term “daily fantasy sports” entered the vernacular – it is not entirely certain whether this “fantasy sports carve-out” covers all forms of “daily fantasy sports.”47 In addition, the carve-out does not seem to protect fantasy sports contests where the ratio of skill-to-chance does not meet a minimum threshold, where the fantasy sports contest’s outcome is based on the performance of either teams in a team sport or individual athletes in an individual sport, or where contestants compete “against the house” as opposed to against, and thus relative to, other players.48

V. FUTURE OF THE “DAILY FANTASY SPORTS” INDUSTRY

This is a fascinating time for those who want to work in the “daily fantasy sports” marketplace, as well as those interested in the marketplace from a legal or academic perspective. Those seeking to enter this marketplace have to look carefully at state and federal laws, as well as garner a nuanced understanding in these laws, and frankly understand some math that involves balancing skill and chance.

The future prospects of the “daily fantasy sports” industry will likely depend on whether industry leaders recognize that the legality of “daily fantasy sports” is

45. 31 U.S.C. §5362(1)(E)(i)-(ix)(2006) (listing a wide range of activities that are explicitly exempted from the Unlawful Internet Gambling Enforcement Act).
46. See id. §5362(1)(E)(ix)(I)-(III) (2006); see also Edelman, supra note 2, at 57-58.
47. See Bonnette, supra note 24, at Kindle Location 208 (discussing the author’s purported “invention” of daily fantasy sports specifically as a strategy for trying to take advantage of what the author perceived as a loophole in the fantasy sports carve-out to the Unlawful Internet Gambling Enforcement Act).
48. See 31 U.S.C. §5362(1)(E)(ix)(II) (stating that the fantasy sports carve-out to the Unlawful Internet Gambling Enforcement Act requires that “[a]ll winning outcomes reflect the relative knowledge and skill of the participants”); id. §5362(1)(E)(ix)(III) (stating that “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”).
not a one-size fits all solution, but rather one that varies based on state and game format. Reason being, maximizing elements of skill and minimizing elements of chance will be imperative for each “daily fantasy sports” business to survive potential legal scrutiny.

Finally, complying with these murky areas of law will not be easy; there is a lot of ambiguity. But, learning the intricacies of how federal and state gambling laws operate can be the difference between whether one operates a legal “daily fantasy sports” business or one finds themselves on the wrong side of the law. Theoretically understanding these distinctions could mark the difference between one achieving great wealth and one finding themselves in jail. But perhaps far more likely, understanding these distinctions will play an important role in determining the ability of any particular “daily fantasy sports” game to garner equity funding and build business relationships with any of the more reputable payment processing companies.

Even if federal and state governments are currently taking a relatively lax approach to challenging the legality of “daily fantasy sports” contests, this could change as the “daily fantasy sports” marketplace continues to grow in size and presence. Understanding the legal issues before that time comes truly seems to be a matter of great importance for all companies operating in this exciting, but still somewhat legally risky, digital marketplace.