The Future of Fantasy Sports: Understanding Regulatory, Legal Issues

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Future of Fantasy Sports: Understanding Regulatory, Political Issues

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November 5, 2015
President George W Bush signed UIGEA into law in October 2006

Regarding UIGEA it is important to note that:

- The law is an amendment to the unrelated SAFE PORT ACT, which was a law passed in response to the potential sale of six major U.S. seaports to Dubai Ports World
- Does not prohibit internet gaming; prohibits businesses from restricted transactions

The law provides an exemption from its prohibitions on fund transfers for “participation in any fantasy or simulation sports game or education game or contest” that meet certain criteria:

- Prizes are pre-determined and can’t be altered based on the number of participants
- Outcomes is based predominantly on skill
- Not based on a single performance of an individual athlete in a single sporting event
- No winning outcome may be based on the score, point spread or performance of any single team

UIGEA does not provide a blanket exemption; state law supersedes
Daily Fantasy Sports in the Crosshairs

- On September 27 a DraftKings employee accidentally releases ownership data before lineups locked
- The same DraftKings employee subsequently wins $350K on FanDuel
- Led to investigations by the New York AG, Massachusetts AG, US Attorney in Tampa and US Attorney Southern District of NY
- Lawsuits – 25 and growing
- Increased state and federal scrutiny
  - Nevada Gaming Control Board: can operate if licensed
  - Federal action – Rep Frank Pallone and Sen Robert Menendez want Congressional action
  - State scrutiny – Illinois, Indiana, Georgia, California, Pennsylvania, to name a few
The landscape has been shifting since the “insider trading” scandal

### Bottom Line – Know Which States are Legal

<table>
<thead>
<tr>
<th>State</th>
<th>Legal 214M people; 68% of pop</th>
<th>Questionable 81M people; 26% of pop</th>
<th>Banned 23M people; 7% of pop</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>Pop</td>
<td>State</td>
<td>Pop</td>
</tr>
<tr>
<td>California</td>
<td>38.8M</td>
<td>Oregon</td>
<td>4.0M</td>
</tr>
<tr>
<td>Texas</td>
<td>27.0M</td>
<td>Mississippi</td>
<td>3.0M</td>
</tr>
<tr>
<td>New York</td>
<td>19.7M</td>
<td>Utah</td>
<td>2.9M</td>
</tr>
<tr>
<td>Illinois</td>
<td>12.9M</td>
<td>Kansas</td>
<td>2.9M</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>12.8M</td>
<td>New Mexico</td>
<td>2.1M</td>
</tr>
<tr>
<td>Ohio</td>
<td>11.6M</td>
<td>Nebraska</td>
<td>1.9M</td>
</tr>
<tr>
<td>New Jersey</td>
<td>8.9M</td>
<td>West Virginia</td>
<td>1.9M</td>
</tr>
<tr>
<td>Virginia</td>
<td>8.3M</td>
<td>Idaho</td>
<td>1.6M</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>6.7M</td>
<td>Hawaii</td>
<td>1.4M</td>
</tr>
<tr>
<td>Indiana</td>
<td>6.6M</td>
<td>Maine</td>
<td>1.3M</td>
</tr>
<tr>
<td>Missouri</td>
<td>6.1M</td>
<td>New Hampshire</td>
<td>1.3M</td>
</tr>
<tr>
<td>Maryland</td>
<td>6.0M</td>
<td>Rhode Island</td>
<td>1.1M</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>5.8M</td>
<td>Delaware</td>
<td>0.9M</td>
</tr>
<tr>
<td>Minnesota</td>
<td>5.5M</td>
<td>South Dakota</td>
<td>0.9M</td>
</tr>
<tr>
<td>Alabama</td>
<td>4.8M</td>
<td>Alaska</td>
<td>0.7M</td>
</tr>
<tr>
<td>Kentucky</td>
<td>4.4M</td>
<td>Wyoming</td>
<td>0.6M</td>
</tr>
</tbody>
</table>

Source: Spectrum Gaming Capital; Fantasy Sports Trade Association; Becker & Poliakoff
Fantasy Sports Is Played by 57 Million People

- Since 1988, the number of participants in fantasy sports has grown at a compound annual growth rate of 20%
- DFS is a relatively new subset that is estimated at 9 million participants
- DFS entry fees are estimated at $1B; expected to reach $18B by 2020, a 78% CAGR

Source: Fantasy Sports Trade Association
## DFS Operators Offer a Variety of Sports

<table>
<thead>
<tr>
<th>Site</th>
<th>Founded</th>
<th>Sports offered</th>
<th>Types of Contests</th>
</tr>
</thead>
<tbody>
<tr>
<td>DraftKings</td>
<td>2012</td>
<td>NFL  MLB  NBA  NHL  MMA  Golf  Soccer  Nascar  eSports</td>
<td>Daily  Season  H2H</td>
</tr>
<tr>
<td>FanDuel</td>
<td>2009</td>
<td>X  X  X  X  X  X  X  X  X</td>
<td>X  X  X  X  X  X</td>
</tr>
<tr>
<td>Draft Ops</td>
<td></td>
<td>X  X  X  X  X</td>
<td>X  X</td>
</tr>
<tr>
<td>Draft</td>
<td>2015</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>StarsDraft (Amaya Gaming)</td>
<td>2014</td>
<td>X  X  X  X  X</td>
<td>X</td>
</tr>
<tr>
<td>Star Fantasy Leagues</td>
<td>2012</td>
<td>X  X  X  X  X</td>
<td>X  X  X</td>
</tr>
<tr>
<td>Kountermove</td>
<td>2010</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Draft Day (Sportech)</td>
<td>2011</td>
<td>X  X  X  X  X</td>
<td>X</td>
</tr>
<tr>
<td>Fantasy Aces</td>
<td>2013</td>
<td>X  X  X  X  X</td>
<td>X  X</td>
</tr>
<tr>
<td>FantasyDraft</td>
<td>2014</td>
<td>X  X  X  X  X</td>
<td>X  X  X</td>
</tr>
<tr>
<td>Fantasy Feud</td>
<td>2011</td>
<td>X  X  X  X  X</td>
<td>X  X  X</td>
</tr>
<tr>
<td>Boom Shakalaka</td>
<td>2014</td>
<td>X  X</td>
<td>X  X</td>
</tr>
<tr>
<td>DraftPot</td>
<td>2014</td>
<td>X  X  X  X  X</td>
<td>X  X  X  X</td>
</tr>
<tr>
<td>Head2Head Sports (Sports Information Group)</td>
<td>1994</td>
<td>X  X  X  X  X  X</td>
<td>X  X  X  X</td>
</tr>
<tr>
<td>SportsLock</td>
<td>2011</td>
<td>X  X</td>
<td>X  X  X  X</td>
</tr>
<tr>
<td>Smash Mouth Fantasy</td>
<td>2014</td>
<td>X  X  X</td>
<td>X  X  X</td>
</tr>
<tr>
<td>Swoopt (theScore)</td>
<td>2011</td>
<td>X  X  X  X</td>
<td>X  X  X</td>
</tr>
</tbody>
</table>

*Source: Spectrum Gaming Capital, company websites*
Well-Known and Respected VC Funds Invest in the Space

While not representative of the entire industry, SGC has tracked nearly $1 billion in venture capital investment in daily fantasy sports sites

<table>
<thead>
<tr>
<th>Site</th>
<th>Founded</th>
<th>Last Equity Funding</th>
<th>Total Raised</th>
<th>Notable Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>DraftKings</td>
<td>2012</td>
<td>Series D</td>
<td>$300</td>
<td>$375 The Raine Group, Atlas Venture</td>
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<tr>
<td>FanDuel</td>
<td>2009</td>
<td>Series E</td>
<td>$275</td>
<td>$363 Pentech Ventures, Piton Capital</td>
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<tr>
<td>Draft Ops</td>
<td>2015</td>
<td>Seed</td>
<td>$7</td>
<td>$7 SV Angel, Ecosystem Ventures</td>
</tr>
<tr>
<td>Draft</td>
<td></td>
<td>Series A</td>
<td>$4</td>
<td>$6 SV Angel, The Chernin Group</td>
</tr>
<tr>
<td>FanDuel</td>
<td>2012</td>
<td>Series A</td>
<td>$2</td>
<td>$4 International Investment and Underwriting</td>
</tr>
<tr>
<td>StarsDraft (Amaya Gaming)</td>
<td>2014</td>
<td>Acquired</td>
<td></td>
<td>$5 Pentagone Investments, KKR</td>
</tr>
<tr>
<td>Star Fantasy Leagues</td>
<td>2012</td>
<td>Series A</td>
<td>$2</td>
<td>$4 International Investment and Underwriting</td>
</tr>
<tr>
<td>Kountermove</td>
<td>2010</td>
<td>Seed</td>
<td>$1</td>
<td>$1 KKR, Shamrock Capital Advisors</td>
</tr>
<tr>
<td>Draft Day (Sportech)</td>
<td>2011</td>
<td></td>
<td></td>
<td>KKR, Shamrock Capital Advisors</td>
</tr>
<tr>
<td>FantasyAces</td>
<td>2013</td>
<td></td>
<td></td>
<td>KKR, Shamrock Capital Advisors</td>
</tr>
<tr>
<td>FantasyDraft</td>
<td>2014</td>
<td></td>
<td></td>
<td>KKR, Shamrock Capital Advisors</td>
</tr>
<tr>
<td>FantasyFeud (Gaming Nation)</td>
<td>2011</td>
<td>Seed</td>
<td>$1</td>
<td>$1 Rubicon VC</td>
</tr>
<tr>
<td>Boom Shakalaka</td>
<td>2014</td>
<td>Seed</td>
<td>$1</td>
<td>Rubicon VC</td>
</tr>
<tr>
<td>DraftPot</td>
<td>2014</td>
<td>Seed</td>
<td>$2</td>
<td>Rubicon VC</td>
</tr>
<tr>
<td>Head2Head Sports (Sports Information)</td>
<td>1994</td>
<td>Acquired</td>
<td></td>
<td>Wicklow Capital</td>
</tr>
<tr>
<td>SportsLock</td>
<td>2011</td>
<td>Series A</td>
<td>$5</td>
<td>$6 Wicklow Capital</td>
</tr>
<tr>
<td>Smash Mouth Fantasy</td>
<td>2014</td>
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<td></td>
<td>Wicklow Capital</td>
</tr>
<tr>
<td>Swoop (theScore)</td>
<td>2011</td>
<td></td>
<td></td>
<td>Wicklow Capital</td>
</tr>
</tbody>
</table>

Source: Spectrum Gaming Capital, Crunchbase, company websites
Casino Industry Does Not Want to End DFS; They Want to Own and Monetize

- MGM is considering investing in fantasy sports leagues – Bloomberg 9/30/14
- Clearly this (DFS) cannot be ignored and it is gambling – Jim Murren quoted in the Las Vegas Review Journal 4/29/15

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Fantasy sports</th>
<th>Casino Patron</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender (male)</td>
<td>66%</td>
<td>49%</td>
</tr>
<tr>
<td>Average age</td>
<td>37</td>
<td>45</td>
</tr>
<tr>
<td>Attained college degree or higher</td>
<td>57%</td>
<td>48%</td>
</tr>
<tr>
<td>Household income &gt;$75,000</td>
<td>47%</td>
<td>32%</td>
</tr>
<tr>
<td>Full-time employment</td>
<td>66%</td>
<td>64%</td>
</tr>
</tbody>
</table>

Source: Fantasy Sports Trade Association; Las Vegas Visitor Profile 2014

The typical fantasy sports player is younger, better educated and wealthier than the typical visitor to a Las Vegas Casino
Future of Daily Fantasy Sports: Is DFS “Legal?”

November 5, 2015

Tim Lowry
Partner
Corporate & Securities
DLA Piper LLP (US)
Points to Consider:

• **Federal Law**
  
  • Several federal statues, focusing today on UIGEA, Wire Act, PASPA

• **State Law**
  
  • Patch-work quilt of gambling enforcement and regulation; a patent inconsistency and lack of cohesion among the laws regulating gambling in our fifty (50) states and the District of Columbia
  
  • States’ 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.
  
  • Principles of Federalism and Tenth Amendment doctrine

• **Other Considerations: Architecture and Compliance**

• **Vehicles to Move Forward Legalized Bridge to Plenary Sports Betting?**
Applicable Legal Framework: Federal Law

- **Federal Law**
  - **Interstate Transportation of Wagering Paraphernalia Act**, 18 U.S.C. § 1953(a)
  - **Travel Act**, 18 U.S.C. § 1952(a)
  - **Unlawful Internet Gambling Enforcement Act**, 31 U.S.C. § 5363
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.
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.
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.”
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 US Attorney General to seek injunctive relief, but professional or amateur sports organizations.
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.
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: State Law (Cont.)
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.


• 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 DFS 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.
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

• Only a limited number of states have affirmatively legislated such activity, and the entire business model is at risk. Other areas requiring consideration:

• **General Corporate/Organizational**: An entity considering offering a daily fantasy sports contest should pay meticulous attention 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. Does business judgment rule insulate against criminal risk?

• **Compliance Committee/Internal Controls**: An entity considering offering a daily fantasy sports contest may consider an internal audit committee, or another organizational arm 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 steer consider risk reward 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.** Questionable AML Compliance procedures in place. 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 may rely upon internal processes, e.g., 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.” Use of internet searches, social media searches, and LexisNexis to authenticate user information after the facts is too late.

• **Financials.** An entity offering any daily fantasy sports contest must demonstrate no affirmative connection between prize amounts and 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, terms of use should be accurate with respect to cancellation rates between different games and promotional/marketing credits (if applicable). Must prescribe friends and family exclusions.
VEHICLES TO MOVE FORWARD:

- Trend Towards Legalization; Strategic Legislative Outreach
- Continued Social Acceptance
- Mitigate Unnecessary Exposure; Inoculate With Independent Investigation By Honest-Broker
- Other Strategic Alignments?
Adding Some Color to the Conversation

Seth Young
Chief Operating Officer
Star Fantasy Leagues
Introduction

- Star Fantasy Leagues Skill Gaming Study
- Regulation: Is it a Bad Thing?
- What is Responsible Operation?
- Why has DFS Resisted Regulation?
- Final Thoughts
The Argument for “Skill Game” Classification

- Star Fantasy Leagues Skill Gaming Study with Gaming Laboratories International
- Showed with empirical evidence that SFL contests are based in skill
- Based on SFL game structure, salary algorithms, game types
- Not translatable to any other DFS operator
Regulation – Is it a Bad Thing?

Light Touch vs Heavy Hand
Responsible Operating

Don't ask permission. If it does not work, you can apologize later.

— Paulo Coelho —
Why is there Industry Resistance to Regulation?
Final Thoughts

Remember the golden rule... We must all live by the golden rule.

What the heck is the golden rule?

Whoever has the gold makes the rules.
Daily Fantasy Sports: Regulatory Considerations

Fredric Gushin
Managing Director
Spectrum Gaming Group
Presenter: Fredric E. Gushin

• Managing Director, Spectrum Gaming Group
• 30+ years gaming regulatory experience
• Former Interim Advisor, US Treasury
• Former Commissioner, Oneida Gaming Commission
• Former Commissioner, Oneida Gaming Commission
• Former Assistant Director/Assistant Attorney General, NJ Division of Gaming Enforcement
  o Led DGE team that worked with Treasury in 1986-1989
  o Assisted in drafting first and second casino regulations
Topics Covered Today

• What might regulation of DFS might look like?
• Who might be the regulators?
• How will this change the industry?
Fundamental Issues

• Is playing real-money fantasy sports gambling?
  – Response to this question critical

• Will this activity be regulated by gaming regulators?
  – Other regulators
  – Consumer Affairs

• State vs. federal regulation
  – States may approach this issue differently
US Gaming

- Proliferation of casinos – almost 1,000 today
  - $68B in GGR, 2014
  - 42 out of 50 states have casinos
- All markets suffered after 2008 recession, oversupply; recovery in local markets second half 2015
- Slots about 80% of revenue in most markets
- Las Vegas Strip down 1.9% year to date (through August)
- Casinos closing in Atlantic City
- Regulation generally kept out organized crime
- Where does DFS fit in?
Opportunities/Challenges

• Regulation of DFS
• Taxation of this activity
• Federal regulation will be difficult
  — State regulation
  — Will FinCEN expand casino regulations?
    • What are risks of DFS?
    • What are the vulnerabilities to money laundering?
• Impact on Indian gaming
History Repeating Itself

• Abuse led to effective control of casinos
  – Nevada, New Jersey became models of regulation for casinos worldwide

• Online gaming
  – Originally resistance to and lack of regulation
  – Located in safe havens
    • Gray-market gaming
  – Violated US law
  – Led to state regulation
History Repeating Itself

• Daily Fantasy Sports
  – Recent scrutiny
  – Self-regulation
    • May be too late for self-regulation
  – Governmental regulation
  – Either way, major changes are in store
  – Uncharted territory
  – Lessons to be learned from gaming regulation
Goals, Objectives of Regulation

- Integrity of regulatory process
  - Maintain public confidence
- Implementation of public policies
- Probity, suitability and licensing
  - Keep out bad guys
  - Keep out organized crime
- Fairness of games
- Assuring that monies are fairly collected and accounted for
Fundamentals of Regulation

• Licensing
• Operational controls
• Geographical limitations?
  – If regulated by the states
• Underage gaming
• Socially responsible gaming
• Taxation
• Anti-money-laundering
States Taking the Lead

• Nevada
  – Determined that fantasy sports constitutes gambling, sports wagering
  – Multiple states have announced hearings
    • Purpose is to lay the foundation for regulation
  – Tied to the sports betting Issue

• Other states
  – Attorneys General and gaming commissions taking lead in many states
  – 13 states introduced DFS bills in 2015 (Legal Sports Report through 10-28-15)
Licensing

• Key component of gaming regulation
  – Ownership subject to suitability determinations
  – Private equity and hedge funds included
    ○ Possible institutional investors waivers
  – Other stockholders might be subject to suitability determinations
  – Key executives subject to suitability determinations
Licensing

- What of vendors providing technical support to DFS operators?
- What of key employees of DFS companies?
- Likely to follow regulation of sports betting in Nevada ...
- ... and online gaming in New Jersey
Operational Controls

• Accountability over funds
• Internal and accounting controls
  – Controls to prohibit insider trading
  – Controls prohibiting employees from playing on their sites
  – Probably need more structure than in place now
• Internal auditing by companies
  – Outside independent auditing
Operational Controls

• Code of Ethics by DFS operators
• Self-exclusion
• Age restrictions
• Geolocation restrictions
  – If regulated by states
Anti-Money-Laundering Issues

• What are they?
  – Risk assessment
  – Compliance plan
  – Independent audits
  – Know your customer
  – Customer due diligence

• Will FinCEN expand casino regulations to include DFS?
Cost of Regulation

- Applicants should pay for costs associated with probity investigations
- Licensees should bear costs of regulation – not public
  - Separate account for regulators
- Typically, startup costs expensive
  - Multiple investigations
- Ongoing regulatory costs
  - Follow Internet gaming model
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Thank you.

... Questions?

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