

Turning Fantasy into Regulatory Reality: A New Approach to Daily Fantasy Sports Laws

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*J.D. Candidate, Columbia Law School, Class of 2017. I would like to thank Professor Richard Brooks for his consistent guidance, positivity, and insight during the drafting process; Professor Eric Talley for his invaluable inputs and perspectives; the staffs, past and present, of the *Columbia Journal of Law & the Arts*, especially Amy Lehrburger '17 and Neal Burstyn '16 for sticking with my Note as it changed and took new shape; and my family, for their support, and for trying to get me to watch football in the first place.

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Early in October 2015, the New York Times broke a budding scandal in the youthful fantasy sports industry. An employee at DraftKings, a Boston-based daily fantasy website, released privileged fantasy draft information before the start of the third week of the National Football League (“NFL”) season.¹ This employee won \$350,000 that same week at FanDuel, a rival daily fantasy website hailing from New York.²

FanDuel and DraftKings have become the two biggest contenders in the fast-growing daily fantasy sports (“DFS”) industry.³ DraftKings alone expected to pay out \$1.2 billion in cash prizes in 2015.⁴ Industry estimates anticipate that \$2.6 billion in contest entry fees will be paid this year across the industry and that by 2020 participation will grow to \$14.4 billion.⁵

Heavy hitters in the sports world have also jumped onto the daily fantasy sports bandwagon. Celebrity athletes like Tom Brady of the NFL’s New England Patriots have signed sponsorship contracts with DFS websites.⁶ While most sports leagues and teams have expressly come out against sports gambling, many now hold financial interests in websites like DraftKings and FanDuel. In July of 2015, Fox Sports, one of the biggest networks for Sunday football games, led a \$300 million funding round for DraftKings.⁷ The previous month, ESPN, currently the biggest sports platform in the world, signed an advertising deal with DraftKings.⁸ The deal, worth an undisclosed amount of money, will involve a “deep integration” of the two companies to “give [DraftKings] an advantage against fantasy rival FanDuel.”⁹ Major League Baseball (“MLB”), the National Basketball Association (“NBA”), Comcast, the National Broadcasting Company (“NBC”), Google, and other

1. Joe Drape & Jacqueline Williams, *Scandal Erupts in Unregulated World of Fantasy Sports*, N.Y. TIMES (Oct. 5, 2015), <https://perma.cc/868Q-MLMX>.

2. *Id.*

3. *Id.*

4. Bob Hohler, *An Uncertain Line Between Fantasy Sports, Gambling*, BOSTON GLOBE (Aug. 2, 2015), <https://perma.cc/2YM2-RMTN>.

5. Drape & Williams, *supra* note 1.

6. Hohler, *supra* note 4.

7. Dustin Gouker, *Are FanDuel and DraftKings Television Partnerships All Locked In After Summer Furry?*, LEGAL SPORTS REPORT (Aug. 12, 2015, 9:53 AM), <https://perma.cc/K9RG-2R7Y>.

8. See Dustin Gouker, *Report: Disney Won’t Invest in DraftKings, Which Gets Exclusive ESPN Deal; Fox Deal Reported, In Trouble?*, LEGAL SPORTS REPORT (June 26, 2015, 5:44 AM), <https://perma.cc/5BA3-XSGH>.

9. *Id.*

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companies have invested in at least one of the two websites.¹⁰ The owners of the Dallas Cowboys and the New England Patriots football teams also have equity stakes in DraftKings.¹¹

Despite this fantasy fervor, the October 2015 controversy caused most states to ban or restrict DFS operations. It also led to legal action. Eric Schneiderman, New York Attorney General, demanded DraftKings and FanDuel stop accepting New York-based players, as their games constituted illegal gambling under New York State law.¹² A class action lawsuit filed by Schneiderman in New York federal court alleged that the two companies “fraudulently induced” players to pay money for contests without proper acknowledgment that company employees could play the contests with privileged information.¹³ At the same time, Nevada banned both sites from operating in-state until the companies and their employees received state gambling licenses—an action that would have officially marked DFS as gambling operations nationwide.¹⁴ In early 2016, Illinois Attorney General, Lisa Madigan, announced that fantasy sports are games of chance and therefore illegal in the state.¹⁵ Conversely, the Florida legislature began work on a bill that would exempt all fantasy sports from state gambling laws.¹⁶

Since last November, eleven states have passed laws legalizing DFS and requiring registration and regulation of all fantasy sports providers—and other states continue to fight for similar laws.¹⁷ Most recently, New York Governor Andrew Cuomo signed a fantasy sports bill into law on August 3, 2016.¹⁸ Attorney General Schneiderman intends to continue with his claims against the two websites.¹⁹ Florida’s bill is in limbo.²⁰ Illinois’ bill is now dead.²¹ The Nevada bill’s status is unclear, although the stance of lawmakers appears unchanged.²² On August 10,

10. *Id.*; Drape & Williams, *supra* note 1.

11. Drape & Williams, *supra* note 1.

12. Joe Drape & Jacqueline Williams, *FanDuel and DraftKings Prepare for Court Fight in New York*, N.Y. TIMES (Nov. 11, 2015), <https://perma.cc/EYU9-Y5QJ>.

13. Edwin Rios, *Inside the Scandal Rocking the Fantasy Sports World*, MOTHER JONES (Oct. 9, 2015), <https://perma.cc/V8AB-CBYJ>.

14. Joe Drape, *DraftKings Continues to Operate in Nevada*, N.Y. TIMES (Oct. 18, 2015), <https://perma.cc/63LW-M6JY>.

15. Nigel Duara, *States Crack Down on Fantasy Sports, Calling Them Games of Chance, Not Skill*, L.A. TIMES (Jan. 2, 2016, 12:10 PM), <https://perma.cc/VA7F-JBAP>.

16. Jim Turner, *Florida House Panel Backs Fantasy Sports Bill*, FOX 13 NEWS (Jan. 13, 2016, 12:10 PM), <https://perma.cc/JJH7-ZC2Y>.

17. Marc Edelman, *New York’s New Fantasy Sports Law Creates Both Business Opportunities and Obstacles*, FORBES (Aug. 10, 2016, 9:30 AM), <http://perma.cc/43FP-VDED>.

18. Rob Perez, *Governor Cuomo Signs Law Allowing Fantasy Sports Back in New York*, FOX SPORTS (Aug. 3, 2016, 5:45 PM), <https://perma.cc/FGK2-ZGP4>.

19. *Id.*

20. See Florida Fantasy Sports Legislation Suffers Another Blow, Prospects Dim for 2016, BRADENTON HERALD (Mar. 4, 2016, 3:30 PM), <https://perma.cc/8PVM-JUCJ>.

21. See Dustin Gouker, *Illinois Daily Fantasy Sports Bill Dead for Now; Focus Returns to DraftKings, FanDuel Lawsuits*, LEGAL SPORTS REPORT (May 29, 2016, 4:24 PM), <https://perma.cc/T77N-YKLV>.

22. See Dustin Gouker, *Nevada Takes Hard Look at Future of Daily Fantasy Sports; DraftKings, FanDuel Speak on Regulation*, LEGAL SPORTS REPORT (March 7, 2016, 5:53 PM), <https://perma.cc/6485-NR5W> (“Most of the [Nevada Gaming Policy Committee] seemed to agree that DFS is a form of sports

2016, Massachusetts Governor Charlie Baker incorporated earlier DFS regulations by Attorney General Maura Healey into a state economic development statute.²³

Time will tell whether these pending laws come to pass, and also whether the passed laws properly protect DFS users from detrimental behavior by DFS website providers. Federal law has proven to be of no help at this time. Under federal sports betting laws, any sports gambling is strictly illegal, save for exemptions in four states.²⁴ Under the Interstate Wire Act of 1961, it is illegal for sports gambling information to be communicated across state lines—unless, of course, both states have legalized sports gambling.²⁵ However, Congress exempted fantasy sports from restriction under the Unlawful Internet Gambling Enforcement Act.²⁶ Courts have also refused to extend the other federal gambling laws to fantasy sports.²⁷ Whether or not the federal laws, and many state laws, apply to DFS depends on whether the games are “games of chance” or “games of skill.”²⁸ States currently disagree on whether fantasy games involve more skill or more chance.²⁹

States that have not done so already should bring the multibillion-dollar fantasy sports industry back to legal legitimacy. It is undesirable for states that have not yet re-legitimized DFS to keep this multibillion-dollar industry illegal without qualification. Unfortunately, besides three statutory obligations under the Uniform Internet Gambling Enforcement Act, there is no federal guidance on how to control these companies. Furthermore, states that now have laws regulating fantasy sports appear focused on settling antiquated concerns of morality, like gambling addiction, social order, and paternalism.³⁰ Their statutes and regulations do not provide significant guidance on establishing internal controls sufficient to prevent cheating insiders from fixing competitions and individual websites from taking advantage of their players.³¹

A look at analogous marketplaces—in particular, stock and derivatives markets and traditional sports gambling institutions—may be useful in figuring out a solution. Legitimate legal speculative activities, like securities trading and traditional sports gambling, have long been analogized and compared, if only anecdotally. “[M]any investors buy stock for some of the same reasons that gamblers may choose certain

betting and is gambling, a concession the industry—in the form of DraftKings’ and FanDuel’s CEOs—was not willing to make.”).

23. Shira Schoenberg, *New Law Ensures Daily Fantasy Sports Remains Legal in Massachusetts*, MASSLIVE (Aug. 10, 2016, 4:36 PM), <https://perma.cc/N97XMNP2>.

24. Andrew Vacca, Note, *Sports Betting: Why the United States Should Go All In*, 11 WILLAMETTE SPORTS L.J. 1, 2 (2014).

25. See *id.* at 5 (“The Interstate Wire Act of 1961 . . . made it illegal for any person to engage in betting or wagering using wired communication such as a telephone.”).

26. See *infra* pp. 40-41.

27. See *infra* p. 41.

28. Nicole Davidson, Comment, *Internet Gambling: Should Fantasy Sports Leagues Be Prohibited?*, 39 SAN DIEGO L. REV. 201, 216-18 (2002).

29. Compare N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1400 (2016) (New York statute declaring daily fantasy sports games to be “games of skill”), with Gouker, *supra* note 21 (Nevada lawmakers seemingly believing that daily fantasy is strictly a “game of chance”).

30. Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling, and the Speculation Paradox*, 86 B.U. L. REV. 371, 402 (2006).

31. See discussion, *infra* notes 247-273.

slot machines, lottery numbers, or squares on a roulette table, or choose to bet or fold a certain poker hand.”³² Professor Christine Hurt finds that, although structurally different, speculative markets and sports betting are not far apart when it comes to the balance of chance and skill required to be successful.³³ Securities Professor Thomas Lee Hazen was also “struck . . . by the similarity between what many label rational investment or bona fide market transactions and gambling, which traditionally has been illegal or alternatively subject to stringent regulation.”³⁴

In Section I of this Note, I review the relevant literature and argue that the old moral and social externality arguments for banning or restricting fantasy sports do not hold up. While no particular path to regulation is the correct path, a comparative analysis of the functional structures of various speculative activities, and the legal and community control mechanisms apparent in each, provide some suggestions for what regulation should look like. In Sections II through V, I compare these speculative activities through four multidisciplinary lenses. In Section VI, I develop a recommended framework for legislation or regulation based on these comparisons and evaluate it against the laws recently implemented in New York and Massachusetts, the respective home states of FanDuel and DraftKings.

I. BACKGROUND LITERATURE AND A NEW APPROACH FOR ANALYZING DFS

With some exceptions, sports gambling is illegal at both the federal and state levels in the United States.³⁵ Only Nevada, Oregon, Delaware and Montana allow gambling on professional and amateur sporting events.³⁶ A number of federal laws implemented over the past century—the 1961 Wire Act, the 1970 Illegal Gambling Business Act and Racketeer Influenced and Corrupt Organizations Act (“RICO”), and the Professional and Amateur Sports Protection Act (“PAPSA”)—have made interstate online sports gambling illegal.³⁷ The prohibition barring sports gambling is thus absolute in the grand majority of cases.

Despite this strict prohibition, Congress has intentionally drafted laws so that they avoid discussing online fantasy sports. For example, the 2006 Uniform Internet Gambling Enforcement Act (“UIGEA”), which made it illegal to “knowingly accept” funds connected to illegal Internet gambling,³⁸ included an explicit carve-out for “fantasy sports games” that meet particular criteria—in particular, games that require “relative knowledge and skill,” among other factors.³⁹

32. Hurt, *supra* note 30, at 373.

33. *See generally id.*

34. Thomas Lee Hazen, *Disparate Regulatory Schemes for Parallel Activities: Securities Regulation, Derivatives Regulation, Gambling, and Insurance*, 24 ANN. REV. BANKING & FIN. L. 375, 402 (2005).

35. *See Vacca, supra* note 24, at 2.

36. *Id.*

37. Robert E. Goeller, Note, *The Money, Man, The Money: Sports Gambling in Professional and Amateur Sports*, 12 WILLAMETTE SPORTS L.J. 1, 2-3 (2015).

38. Unlawful Internet Gambling Enforcement Act of 2006, 31 U.S.C. §§ 5361-5366 (2006); *see also Edelman, supra* note 17.

39. *Id.* § 5362.

Despite UIGEA's seeming clarity, fantasy sports still attract the scrutiny of legal academics bent on determining their legality or illegality. Scholar Erick Lee, for example, found that fantasy sports games do not constitute illegal sports betting, and are not plagued with the same public policy problems as traditional gambling; only "limited statutory regulation within hyper-competitive [high payout] fantasy sports leagues" should be enacted.⁴⁰ On the other side of the debate, scholar Nicole Davidson looked to the common law of gambling, distinguishing between "games of chance" and "games of skill," and determined that fantasy sports more likely rely on chance than skill.⁴¹ Davidson argues that this, coupled with the entrance fee "consideration" most participants pay, puts fantasy sports in conflict with federal and state laws.⁴²

Most of this scholarship pertains to the old guard of fantasy sports. In the traditional model, which I will call seasonal fantasy sports ("SFS"), participants can join leagues made up of friends or strangers, for free or for a nominal prize fee; pick combinations of players to form into a fantasy roster; and then face individual members of the league every week. Points are accumulated according to individual and team game statistics. Even DFS websites measure at least thirty categories of statistics, including receiving yards, lost fumbles, and two-point conversions, when meting out points.⁴³ The player that ends the week with the most points wins. Only at the end of the season would any payments be distributed to a winner. Traditional SFS leagues take place over the course of months.

By contrast, pay-to-play DFS websites have led to an explosion in fantasy rounds that are as short as a week, or even a day. These range from "head-to-head" games where two players pay a set buy-in and play against each other, the winner getting both buy-ins as a prize, to "Guaranteed Prize Pool" games with potentially thousands of participants and predetermined prizes, sometimes as high as \$1 million.⁴⁴

Pay-to-play DFS websites are still so novel that little scholarship has discussed their legality to date. What scholarship does exist suggests that these games are exempted under UIGEA and other federal statutes, and therefore still legal. Scholar Nathaniel Ehrman found that daily fantasy sports games may require less chance, and more skill, than traditional fantasy sports.⁴⁵ "In fact, managing a team for a daily fantasy game is often more time consuming and difficult than it is for season-long leagues . . . [Therefore,] there is a strong argument that daily fantasy requires more research, planning, and thought than traditional season-long leagues."⁴⁶

40. Erick S. Lee, Note, *Play Ball! Substituting Current Federal Non-Regulation of Fantasy Sports Leagues with Limited Supervision of Hyper-Competitive Leagues*, 29 LOY. L.A. ENT. L. REV. 53, 87, 89 (2008-2009).

41. See Davidson, *supra* note 28 at 216-19, 229.

42. See *id.* at 228-29.

43. *Daily Fantasy Football 101*, DAILY FANTASY SPORTS 101, <https://perma.cc/X3UP-GCP9> (last updated Sept. 7, 2016).

44. Josh Shephardson, *Types of Games*, DAILY FANTASY CAFÉ, <https://perma.cc/397K-K4UE> (last updated Sept. 7, 2015).

45. Nathaniel J. Ehrman, Note, *Out of Bounds?: A Legal Analysis of Pay-to-Play Daily Fantasy Sports*, 22 SPORTS L.J. 79, 104 (2015).

46. *Id.*

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As New York reopens its doors to fantasy sports, the time seems ripe to re-evaluate the legal treatment of this industry. In order to complete this analysis, I compare the operational, contractual, and regulatory features of sports gambling and fantasy sports, both traditional and daily. However, many aspects of fantasy sports make speculative markets, like stock and derivatives markets, relevant as well.

The similarities between securities trading and gambling have not been overlooked. Hazen found that, while given distinct statutory treatment, the line between *illegal* gambling and *legal* securities trading is not clearly drawn.⁴⁷ Useful to this analysis is Professor Hurt's framework. To Hurt, attempts to distinguish most any kind of investing from gambling are "illusory."⁴⁸ She thus rejects the traditional distinction, still used by courts today, of "games of chance" versus "games of skill" and replaces it with a "spectrum of speculation" ranging from games of pure chance to games of pure skill.⁴⁹ Sports betting, stock trading, and insider sports betting all sit right in the middle, between pure chance and pure skill. She also finds trading in derivatives markets and day trading to be more chance-based than sports betting; meanwhile, illegal insider sports betting and insider stock trading are more based in skill than individual stock trading.⁵⁰

In their attempts to justify fantasy sports as something other than illegal sports gambling, scholars focus primarily on the regulatory differences between stock trading and sports gambling, and then consider fantasy sports as a sore-thumb exception to restrictions on sports gambling.⁵¹ This may be because it is difficult to come up with many legitimate reasons to ban sports gambling on the one hand, but allow speculative trading on the other.

Hurt points to dated arguments for paternalism, social order, and morals as reasons for history's disdain for gambling.⁵² "Arguments against gambling may focus on the immorality of either striving to achieve something without earning it or worshiping luck and therefore straying from monotheistic Judeo-Christian teachings."⁵³ Hazen suggests that investing is "generally seen as involving risk-shifting or other legitimate economic benefits," while gambling is not—although Hazen suggests this may be a condition of social norms.⁵⁴ Hazen also suspects that the differences of "the parties and their respective motives" in the different transactions may contribute to the different legal treatment of gambling versus investment.⁵⁵

While there are legitimate side effects of gambling that make it especially detrimental—its addictive nature and its attraction of poor, uneducated participants who gamble with the "hope of changing their lives"—many of these detrimental side

47. See Hazen, *supra* note 34, at 375.

48. Hurt, *supra* note 30, at 377.

49. See *id.* at 377-78.

50. See *id.* at 381-86, 387-90.

51. See Hazen, *supra* note 34, at 403 ("The illegality of, and law's disdain for, gambling has moral overtones which makes it difficult to draw the line between bona fide market transactions and a wager.").

52. See *id.* at 402-03.

53. *Id.* at 402.

54. See Hazen, *supra* note 34, at 377.

55. *Id.*

effects may also appear in stock trading.⁵⁶ “For both the compulsive gambler and trader, losses may be substantial, and we know that the average speculator in these activities loses money . . . In nightmare scenarios, managers of pension funds may create almost limitless negative effects on various groups through reckless trading.”⁵⁷ Economist John Maynard Keynes once observed, “it is usually agreed that casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of Stock Exchanges.”⁵⁸

Moreover, it is not clear how much the morally undesirable elements of gambling are replicated in fantasy sports. For example, while a minor could sneak into a casino or racetrack and gamble with cash, it is less obvious that they could, or would, steal a credit card and verifying information to pay fees on a fantasy website. At the same time, when a DFS website like DraftKings is readily available with the click of a mouse, “[t]here appears to be a greater chance for a daily fantasy player to become a compulsive gambler, a dishonor associated with sports gamblers.”⁵⁹ In short, trying to determine proper regulatory treatment of DFS websites through the lens of moralistic and social policy concerns is imprecise, and runs the risk of forbidding marginally problematic activities.

My intention is to add new considerations into the debate. Since so many aspects of gambling are considered illegal, and in nearly all states gambling contracts are simply not enforced, most studies avoid contractual analysis of gambling transactions.⁶⁰ However, there are multiple focal points apparent in speculative trading, traditional sports gambling (namely pari-mutuel betting), and fantasy sports that affect each activity’s capacity to be regulated, or to regulate itself. All three speculative activities have unique operational structures, functions of participation and consideration,⁶¹ community enforcement or “self-regulation,” and statutory/regulatory enforcement. Each of these lenses, when applied to DFS, informs how the government could regulate four particular concerns of DFS operations: the balance of power between the individual players versus the provider sites, their ability to address grievances and spot misfeasance from within the companies, the mechanisms for enforcing rules within the companies, and methods for ensuring DFS providers are incentivized legally and economically to act according to the law. Out of this comparison, I cull a hypothesis suggesting the best overall approach to fantasy sports regulation.

56. Kiran Raj, Comment, *Drawing a Line in the Sand: How the Federal Government Can Work with the States to Regulate Internet Gambling*, 56 EMORY L.J. 777, 795 (2006).

57. Hurt, *supra* note 30, at 405-06.

58. Hazen, *supra* note 34, at 403.

59. Michael Trippiedi, Note, *Daily Fantasy Sports Leagues: Do You Have the Skill to Win at These Games of Chance?* 5 UNLV GAMING L.J. 201, 221 (2014).

60. See generally Joseph Kelly, *Caught in the Intersection Between Public Policy and Practicality: A Survey of the Legal Treatment of Gambling-Related Obligations in the United States*, 5 CHAP. L. REV. 87 (2002).

61. See “Consideration,” BLACK’S LAW DICTIONARY 370 (Bryan A. Garner ed., Thomson Reuters 10th ed. 2014), for the traditional definition of “consideration” (“Something (such as an act, a forbearance, or a return promise) bargained for and received by a promisor from a promisee; that which motivates a person to do something, esp. to engage in a legal act.”).

II. THE OPERATIONAL STRUCTURES OF THE SPECULATIVE ACTIVITIES

A. SPECULATIVE FINANCIAL MARKETS

1. Stock Exchanges

For the sake of this Note, “securities” will represent, generally, stocks (on the primary and secondary markets) and derivatives. Both have particular similarities and differences that are relevant to DFS, and recent controversies surrounding the derivatives markets mirror some of the complaints against DFS. Both stocks and derivatives function within the traditional exchange model, or “clearinghouses” for derivatives, and within the over-the-counter (“OTC”) model,⁶² in which securities are traded through dealer networks.⁶³

Exchanges and clearinghouses operate as intermediaries. They bring together sellers and buyers and, depending on the distribution of information through the market, informed and uninformed market participants.⁶⁴ Their critical function is to provide a marketplace where stocks can be easily bought and sold.⁶⁵ They also provide liquidity, making sure prices remain relatively steady between trades.⁶⁶ Stock exchanges may be identified as market organizers, information distributors, market regulators, standards setters, and business enterprises.⁶⁷ Their effectiveness and efficiency depends on the “auction trading principle”—centralization of buying and selling interest into one location, historically the exchange floor.⁶⁸ However, newer automated trading systems and online exchanges still operate as centralized marketplaces, and therefore, still adhere to the auction trading principle.⁶⁹

In a traditional auction market, like the New York Stock Exchange (“NYSE”), individual broker firms will work on the exchange floor or network. The firms, through their floor brokers, receive and execute contracts for buying or selling shares of a particular stock.⁷⁰ They operate as agents to the investors. The investor is the buyer or seller. The exchange is not directly involved with the transaction, but plays a regulatory role on all parties.⁷¹

Before online trading proliferated, the controls of stock markets were manifested

62. See generally MARC LEVINSON, *THE ECONOMIST GUIDE TO FINANCIAL MARKETS* (Economist Books, 6th ed. 2014).

63. *Over-The-Counter—OTC*, INVESTOPEDIA, <https://perma.cc/2HY3-6GE2>.

64. Cf. Andreas M. Fleckner, *Stock Exchanges at the Crossroads*, 74 *FORDHAM L. REV.* 2541, 2545 (2006) (Fleckner refers only to stock exchanges, but their function as intermediaries, as Fleckner explains it, applies equally to clearinghouses).

65. See *id.* at 2546.

66. See *id.*

67. *Id.* at 2545-46.

68. See Therese H. Maynard, *What Is an “Exchange?”—Proprietary Electronic Securities Trading Systems and the Statutory Definition of an Exchange*, 49 *WASH. & LEE L. REV.* 833, 834 (1992).

69. See *id.* at 835.

70. Cf. Fleckner, *supra* note 64, at 2546.

71. See discussion, *infra* notes 164-175; see also discussion, *infra* notes 192-212.

in specialists.⁷² Specialists connected buyers and sellers and handled information flows between them.⁷³ They calculated the spread between buy and sell orders and coordinated the number of stocks being sold versus the number of stocks in demand, thus ensuring stock liquidity.⁷⁴ Specialists had almost exclusive access to the activity of the stocks they managed and exclusive control and knowledge as to the stock information.⁷⁵ The specialist thus served a function similar to the bookie or the fantasy sports website. With current online and decentralized OTC trading, market makers handle deals between brokers.⁷⁶ The market makers post bids and ask prices through the network, which broker firms then use.⁷⁷ Computers can automatically match buyers and sellers in the absence of market makers.⁷⁸

2. Derivatives Clearinghouses

Derivatives clearinghouses operate similarly. The biggest difference is the nature of the contract being sold, which will be discussed below.⁷⁹ Historically, derivatives were mostly sold over the counter.⁸⁰ However, following the financial crisis, Title VII of the Dodd-Frank Act introduced central counterparty “clearinghouses,” or “CCPs,” to stifle the OTC derivatives market.⁸¹ Clearinghouses create “hub and spoke” relationships with the parties to the contract; they purchase all interests from sellers and sell all interests to buyers.⁸² Unlike a stock exchange, a clearinghouse must maintain its own finances, and therefore must remain solvent to operate.⁸³

Unlike stocks, which are often purchased by individual investors, the primary dealers in derivatives are major investment banks that try to hedge the risks on whatever financial instruments they may hold.⁸⁴ These major banks also prefer dealing with other large entities, due to their higher credit ratings and access to other

72. THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 17 (West Publishing, 6th ed. 2009).

73. *Id.* at 389.

74. *Cf.* Maynard, *supra* note 68, at 857.

Prior to [a major SEC study], the SEC had become concerned about the monopolistic position of the specialist post on the NYSE, particularly the specialist's almost exclusive access to the order flow activity in its allocated securities and its exclusive control over and knowledge of the limit book for those securities. The SEC reasoned that this monopolistic position insulated the specialist from significant price competition, and that this may have allowed the price spreads to remain artificially high.

75. *See id.* at 857.

76. *See id.* at 849.

77. Dana Atwood Lukens, Note, *Regulation for the Securities Markets?*, 10 ANN. REV. BANKING L. 379, 382 (1991).

78. *Id.* at 382.

79. *See* discussion, *infra* notes 107-127.

80. *See* Sean Griffith, *Governing Systemic Risk: Towards a Governance Structure for Derivatives Clearinghouses*, 61 EMORY L.J. 1153, 1159 (2012).

81. *See id.* at 1175-76.

82. *Id.* at 1175.

83. *Id.* at 1176.

84. *See id.* at 1190-91.

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financial instruments.⁸⁵ The players in derivatives markets are therefore bigger, and are more likely to engage directly with the individual transactions.

B. PARI-MUTUEL WAGERING

Fewer parties exist in sports betting than in securities trading. The bookie (also known as the “track”) arranges and coordinates the bets, calculates the odds, and distributes odds information.⁸⁶ While bookies are the main source of information about the odds, statistics and new developments in the event are distributed by sports news sources, or through media communications at the sporting event itself. The individual bettors deal directly with the bookie, or with an agent of the bookie, to place their bets.⁸⁷ Their money is held by the bookie. After the bet-upon event, the bookie distributes the prize to the winning bettors.

Most states only allow sports gambling at the tracks, but some are more lenient. In New York, Off-Track Betting (“OTB”) sites allow gamblers to bet from remote locations.⁸⁸ Online horse betting is also allowed in the state.⁸⁹ Online horse betting here “is nothing more than remote gambling,” so the different forms of gambling do not operate in a substantially different manner.⁹⁰

Sportsbooks, centralized providers of gambling outlets for a wide variety of sports, are also prevalent online.⁹¹ However, except for Nevada, Delaware, Montana, and Oregon, sports bookmaking is illegal under the Professional and Amateur Sports Protection Act.⁹² Even in Nevada and Delaware, sportsbooks are insignificant—Nevada’s legal sports wagering accounted for less than one percent of all nationwide sports betting in 2012.⁹³ Nevada sportsbooks extend beyond horse racing to football, basketball, and even to more niche betting opportunities.⁹⁴ The structure of sportsbooks is substantially the same as the structure of pari-mutuel gambling operations.

85. Sean Griffith, *The Derivatives Clearinghouse: Designing A Governance Structure to Manage Systemic Risk*, 32 BANKING & FIN. SERVICES POL’Y REP., no. 4, 13, 16-17 (2013).

86. See M. Shannon Bishop, Note, *And They’re Off: The Legality of Interstate Pari-Mutuel Wagering and Its Impact on the Thoroughbred Horse Industry*, 89 KY. L.J. 711, 716 (2000-2001).

87. *Id.*

88. See Off-Track Betting, OFFTRACKBETTING.COM (last accessed Oct. 13, 2016), <http://www.offtrackbettingnewyork.com>.

89. Ryan Delaney, *Why Betting on Horses Is Legal, When Gambling Elsewhere Is Not*, INNOVATION TRAIL (Apr. 30, 2012), <http://perma.cc/Q9WQ-URGU>.

90. See Anthony Cabot & Robert Faiss, *Sports Gambling in the Cyberspace Era*, 5 CHAP. L. REV. 1, 10 (2002).

91. See *id.* at 10.

92. Chad Millman, *Delaware Allows Sports Betting*, ESPN (May 13, 2009), <http://perma.cc/XHL6-PP7J>; see also *infra* at 0.

93. Matthew Mills, Note, *The Failure of the Professional and Amateur Sports Protection Act*, 16 U. DENV. SPORTS & ENT. L.J. 215, 224 n.64 (2014).

94. See Marah Eaklin, *Who Makes Oscar Odds in Vegas, and What’s the Best Way to Win a Pool?*, A.V. CLUB (Feb. 28, 2014, 12:00 AM), <http://perma.cc/EDB7-JR44>.

C. SEASONAL AND DAILY FANTASY SPORTS

There are notable differences between seasonal and daily fantasy sports, and it is necessary to differentiate the two. While the structures of play are similar, time frames and monetary incentives create major differences, especially from a regulatory perspective.

The parties to the competitions vary. Professor Marc Edelman notes six different groups of stakeholders within seasonal fantasy, four of which are relevant here. Participants are the players who compete.⁹⁵ Host sites are the websites that store league data and publish statistics and news updates.⁹⁶ Host sites resemble the specialist of stock exchanges, or the bookie in gambling. Commissioners manage the league rules and solve disputes among players in a seasonal league.⁹⁷ Treasurers collect participants' money at the beginning of a season and pay the winners at the end.⁹⁸

In a seasonal league, all the stakeholders may be separate. The host site can be an established provider or a custom website established by the league itself.⁹⁹ The commissioner and treasurer are usually also participants, and other participants know them as family or friends or coworkers. With some host sites, either the site itself serves as treasurer, or a member of the league deals with all the money in the league.¹⁰⁰ By contrast, in a large DFS game the host site, commissioner, and treasurer are all one entity. DraftKings and FanDuel, as examples, set their own rules for how games will be played and how money will be distributed and received, collect and distribute money, and ensure players follow the rules.¹⁰¹ This means there are only two true groups of stakeholders in DFS—the participants and the hosting website.

III. PARTICIPATION AND CONSIDERATION IN THE ACTIVITIES

A. INVESTING IN SECURITIES

A stock transaction begins when the investor communicates to his brokerage firm

95. Marc Edelman, *A Short Treatise on Fantasy Sports and the Law: How America Regulates its New National Pastime*, 3 HARV. J. SPORTS & ENT. L. REV. 1, 16 (2012).

96. *Id.* at 19.

97. *Id.* at 21.

98. *Id.* at 22.

99. *Id.* at 19-21.

100. *See generally* Yahoo! Sports Fantasy Basketball, YAHOO! FANTASY (last visited Jan. 16, 2016), <https://basketball.fantasysports.yahoo.com/nba/reg/joinleague/private> (Yahoo! Offers both free and custom leagues; a quick perusal of their database shows that some leagues require minimal entry fees, with small prizes. The person who creates the league may determine the payouts, serving as a form of commissioner.)

101. *See* Drape & Williams, *supra* note 1. (“The data that DraftKings acknowledged was released by its employee, Ethan Haskell, showed which particular players were most used in all lineups submitted to the site’s Millionaire Maker contests. Usually, that data is not released until the lineups for all games are finalized. Getting it early, however, is of great advantage in making tactical decisions, especially when an entrant’s opponents do not have the information at all . . . Many of these employees set the prices of players and the algorithms for scoring. In short, they make the market.”)

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that he would like to purchase stock.¹⁰² The brokerage firm then sends its floor broker out with the order.¹⁰³ The broker goes to the specialist in that particular stock.¹⁰⁴ The specialist then pairs the buyer with a seller and executes the purchase.¹⁰⁵ The shares are then delivered to the buying investor.¹⁰⁶

The buying investor now owns shares which exist perpetually; they continue to exist even if the investor decides to sell them. During the existence of the shares, they always have some monetary value. Depending on the state of the world, or the real-life events that may affect the value of the stock, the stock's monetary value may increase or decrease, but rarely, if ever, reach zero. The investor is allowed at any point to sell or buy more stock. Payoff, the determination of the final value of the share to the seller, occurs when the stock is sold, and in some cases perpetually via dividends. Payoff always happens, regardless of whether it means loss or gain for the investor.

1. Forms of Consideration

Stock markets rely on several considerations to attract and secure traders, particularly minority shareholders. Traders want accurate and thorough information about the value of a business.¹⁰⁷ They also want a guarantee that, if a company trades on the market, that company's managers and shareholders will not cheat them out of all or most of the value of their investment.¹⁰⁸ Attorney Dana Atwood Lukens finds that the efficacy of stock markets depends on four particular elements: adequate and reliable information for participants; a "level playing field" in which no one party has an unfair advantage; fair, orderly execution of investment decisions; and a stable, liquid market.¹⁰⁹

The investors at the stock exchange provide as consideration their money and continued use of the exchange, and their abiding by the rules and restrictions of the exchange.¹¹⁰ The stock exchange in turn provides a centralized, organized location for investors to trade their stocks; a regulated system that prevents abuses; fair, open and reliable information; and a system that allows quick and definite execution of sales and purchases of stocks.¹¹¹

2. Comparison: Purchase of CDO Derivatives

Derivatives sales work similarly, but with large dealers interacting directly with

102. Nan S. Ellis et al., *The NYSE Response to Specialist Misconduct: An Example of the Failure of Self-Regulation*, 7 BERKELEY BUS. L. J. 102, 109 (2010).

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. See generally Bernard Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781 (2001).

108. See *id.* at 783.

109. See Lukens, *supra* note 77, at 381.

110. See discussion, *supra* notes 62-78.

111. See Lukens, *supra* note 77, at 381.

the market.¹¹² The central counterparty clearinghouse (“CCP”) will purchase from the sellers and then sell to the buyers.¹¹³ “[T]he clearinghouse agrees to act as a buyer in each transaction in which a clearinghouse member seeks to enter into a contract as a seller,” and vice versa.¹¹⁴ Buyers and sellers may remain anonymous. To ensure both parties follow through, the CCP may require performance bond collateral; if a party fails to satisfy its financial obligations, the CCP will liquidate their position and the collateral.¹¹⁵

Unlike a stock, a derivative does not represent a tangible financial commitment, like ownership in a company; it is a contract conditioned upon a particular market metric.¹¹⁶ For example, a Collateralized Debt Obligation (“CDO”) measures a basket of assets, like loans and mortgages.¹¹⁷ The buyer pays the seller a fee. If a financial event occurs to the basket of assets, the seller promises to pay the buyer a predetermined amount.¹¹⁸ Similarly, a Credit Default Swap (“CDS”) measures the credit performance of an individual or corporation.¹¹⁹ If that party defaults, then the seller pays the buyer.¹²⁰ While typically these derivatives are used to hedge risks by the holders of the assets, “naked” derivatives can be purchased speculatively, without any correlating assets; a dealer that believes particular parties will default on their loans may purchase a CDS on that party and snag a substantial payday.¹²¹

Comparing CDS agreements to the other agreements in this article may be difficult; “every swap transaction is unique, like a snowflake.”¹²² Comparison depends on the nature of the asset basket and the derivative variant; certain derivatives, like futures, terminate at a predetermined date,¹²³ while options give the buyer a right to buy an asset at their discretion.¹²⁴ Unlike stocks, derivatives sometimes (when speculative) benefit one party and harm the other. While buyers

112. Griffith, *supra* note 80, at 1190-91.

113. John W. McPartland, *Clearing and Settlement of Exchange-Traded Derivatives*, CHI. FED. LETTER (Fed. Res. Bank Chi., Ill.), no. 267, Oct. 1, 2009. See Griffith, *supra* note 80, at 1175.

114. Kristin Johnson, *Clearinghouse Governance: Moving Beyond Cosmetic Reform*, 77 BROOK. L. REV. 681, 693 (2012).

115. See McPartland, *supra* note 113.

116. See Griffith, *supra* note 80, at 1159.

117. Neal Deckant, *Criticisms of Collateralized Debt Obligations in the Wake of the Goldman Sachs Scandal*, 30 REV. BANKING & FIN. L. 407, 410 (2010).

118. See Benjamin O’Connor, Comment, *Taming the Wild West of Wall Street: Regulating Credit Default Swaps after Dodd-Frank*, 48 J. MARSHALL L. REV. 565, 573-74 (2015).

119. *Id.*

120. *Id.*

121. Jennifer O’Hare, *Synthetic CDOs, Conflicts of Interest, and Securities Fraud*, 48 U. RICH. L. REV. 667, 671 (2014).

122. Charles W. Murdock, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Succeed in Preventing Future Crises?*, 64 SMU L. REV. 1243, 1323 (2001) (quoting *The Financial Derivatives Supervisory Improvement Act of 1998 and the Financial Contract Netting Improvement Act: Hearing on H.R. 4062 and H.R. 4239 Before the H. Comm. on Banking and Fin. Services*, 105th Cong. 22 (1998) (statement of Mark C. Brickell, Managing Director, J.P. Morgan Securities, Inc.), available at http://commdocs.house.gov/committees/bank/hba50076_of.htm).

123. See Reem Heikal, *Futures Fundamentals: How the Market Works*, INVESTOPEDIA (last visited Aug. 17, 2016), <https://perma.cc/U4NQ-8KQ7>.

124. *Options Contract*, INVESTOPEDIA (last visited Oct. 6, 2016), <https://perma.cc/QU37-69NY>.

who hold the assets either lose less or earn less on the performance of their assets, “it is mathematically impossible for both sides to a purely speculative derivative contract to each profit from their trade, just as it is impossible for two gamblers to both win a bet.”¹²⁵

Consideration for derivatives likely does not vary much from stock sale consideration. Trust may factor more strongly in derivative consideration, because most derivatives are over-the-counter (“OTC”). Yet due to post-2008 controversy surrounding derivatives, trust that a seller will fulfill her end of the contract is perhaps poorer here than in a stock trade. Counterparty risk—risk that the seller will become insolvent and be unable to pay the buyer—is common in OTC CDS markets; widespread counterparty default is considered a central precipitant of the 2008 financial crisis.¹²⁶ Because both sides of a derivative transaction hope to gain from it at the other’s expense, perverse incentives exist that may neutralize the benefits of any consideration. CCPs are meant to counter this problem, but it is not clear if a CCP would be able to fulfill defaulted debt obligations at a large scale, as occurred in 2008.¹²⁷

B. PLACING A PARI-MUTUEL BET

Pari-mutuel horse betting does not utilize fixed odds—the bettors are not betting against the racetrack or the bookie itself, but against other bettors.¹²⁸ The payoff to the winners depends on the distribution of bets: a large number of bets on one horse creates a small payoff, while a small number of bets on another horse creates a much larger payoff, although the chances of winning the bet are likely correspondingly small.¹²⁹ The racetrack does not bet against any of the bettors or favor any participant in the race.¹³⁰ Rather, the racetrack takes a minimal commission from all participants.¹³¹

Unlike stocks, there is no transfer of an instrument; both bettors pay and receive a ticket. Only one gets the payoff.¹³² A stake in a bet is not perpetual, but ends upon occurrence of the event on which the bet is based. The stakeholder then wins and cashes out to receive a payoff, or loses and receives nothing. The odds disfavor payoff. There is no opportunity to renegotiate the terms of the bet. The stakeholder can bet more money at any time, but this is not an informed renegotiation of the

125. Lynn Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 30 BANKING & FIN. SERVICES POL’Y REP., no. 12, 14 (2011) (emphasis omitted).

126. See Alexander Charap, Article, *Minimizing Risks, Maximizing Flexibility: A New Approach to Credit Default Swaps Regulation*, 11 J. BUS. & SEC. L. 127, 136-37 (2011).

127. Johnson, *supra* note 114, at 692-95.

128. *Pari-Mutuel Betting*, THE SPORTS GEEK (last visited Sept. 17, 2016), <https://perma.cc/6LT9-ZSHU>; see also M. Shannon Bishop, *And They’re Off: The Legality of Interstate Pari-Mutuel Wagering and its Impact on the Thoroughbred Horse Industry*, 89 KY. L.J. 711, 715-716 (2000-2001).

129. Bishop, *supra* note 128, at 716.

130. See *id.*

131. *Id.* (“For pari-mutuel wagering, the money bet on a race is pooled, and approximately eighty percent is returned to the bettors who won the race. The remaining twenty percent, the ‘takeout,’ is distributed among . . . the horsemen, and the racetrack owners.”)

132. See *id.*

original contract, using new information to reassess risk. Once the race is completed, there is nothing left to negotiate. Sports gambling contracts, unlike stocks, thus “involve[] simply sterile transfers of money or goods between individuals, creating no new money or goods.”¹³³

In a horse race bet, a bettor pays the racetrack to participate. There may be the unspoken consideration or promise that the bettor will not cheat or attempt to rig the sporting event in some way. In return, the bookie provides the bet ticket, as well as information on the events being bet upon—although, of course, the bettor can receive this information from sports news or from watching the event itself. The racetrack also promises to pay out in the event that the bettor wins the bet. If the event happens, the bettor is entitled to the performance. If the event does not happen, no performance is required, but the bet contract has been satisfied. This is important consideration, especially with online bookies. “Anyone who gambles over the Internet is making a sucker bet” because, even if the bettor wins, there is no absolute guarantee that the winner will get his or her payout.¹³⁴ A site operator may shut down after receiving bets, or a negligent site operator could just lose the funds.¹³⁵ Therefore, one of the biggest hurdles for Internet betting is gamblers’ lack of trust.¹³⁶

C. PLAYING A FANTASY GAME

1. Rules of Participation: SFS and DFS

Both forms of fantasy sports center around the roster. Contestants customize a virtual team, usually of athletes from different teams, with different combinations of statistics. The contestants are then awarded points based off the statistics their selected athletes receive over the course of the contest.¹³⁷ For example, one contestant can simultaneously rack up points from the Green Bay Packers’ quarterback and from the Miami Dolphins’ linebacker. Depending on the league, athletes are allocated either by a “traditional auction,” where participants are given a set amount of points to bid on certain athletes; a “modified auction,” where athletes have set prices and multiple participants may pick them; a “league” or “snake” draft, where contestants select players in a rotation; and software-based “autopick,” which selects athletes at random.¹³⁸

Seasonal fantasy tends to rely on the league draft.¹³⁹ Meanwhile, DraftKings and FanDuel rely on a version of the modified auction.¹⁴⁰ Some argue that the modified

133. John Warren Kindt, *Legalized Gambling Activities: The Issues Involving Market Saturation*, 15 N. ILL. U. L. REV. 271, 271 (1995) (quoting PAUL A. SAMUELSON, *ECONOMICS* 245 (10th ed. 1976)) (emphasis omitted).

134. Brent J. Goodfellow, *Betting on the Future of Sports: Why Gambling Should Be Left Off the Field of Play*, 2 WILLAMETTE SPORTS L.J. 21, 36-37 (2005).

135. See Cabot & Faiss, *supra* note 90, at 12.

136. *Id.* at 11-12.

137. Ehrman, *supra* note 45, at 85.

138. Edelman, *supra* note 95, at 13-15.

139. See Ehrman, *supra* note 45, at 86-87 (“Season-long fantasy sports usually utilize a snake draft.”).

140. See Michael Nelson, *How to Make a Killer Daily Fantasy Sports Football Roster on DraftKings*

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auction or “salary cap” format actually adds an element of skill to DFS; it “introduces economic analysis and requires payers to strategize how to value players and allocate their roster funds.”¹⁴¹

The roster is a giant difference between fantasy sports and sports gambling. Pari-mutuel horse bets can rest on only one horse in one race, or several horses in several races. Statistics like age and past results are only useful in deciding the yes-or-no question: whether or not to pick a horse.¹⁴² The points-based fantasy roster, by contrast, rests upon total accumulation of points. One athlete on the roster can do poorly, but their accumulated statistics still help the point total. There are many categories of points on which a player can score. As long as any combination of athletes on the roster earns enough points, a participant can still win the game.

With the seasonal fantasy league, the participant pays the fee and then creates a roster. At any time throughout the duration of the league, the participant can renegotiate the roster. The participant then either receives a payoff (by winning) or nothing (by losing). In some leagues, second place or consolation prizes exist. The end payoff may sometimes not include money at all. With DFS, the games are substantially shorter and participants are less likely to know each other, so the monetary payoff becomes a bigger incentive to participate. “[B]ecause an owner can play what is essentially a new ‘league’ every day, the chance to win or lose is multiplied many times over.”¹⁴³ The operating website, rather than an individual, receives all funds, distributes all information, and maintains rosters. The website also takes a commission from entry fees, similar to the bookie’s commission.¹⁴⁴

DFS rosters are not always created on the first day of the season, but are most often created once the daily competition itself is launched by the website. It is also possible that the participant may renegotiate the roster at any time up until the end of the game. However, there are no future dates for the participant to rely upon; the only realizing events are the one or two games that decide the entire competition. While the DFS roster may, like the SFS roster, contain many players from different teams, participants have mere hours to set the roster, giving them little time, and likely little incentive, to swap out athletes based on new information. Once an athlete has played that day, they are no longer useful to the DFS participant.

Like the SFS league, the DFS round ends with either payoff or nothing; however, it is important to reemphasize the weight of the payoff in the transaction. While the seasonal league is an environment of camaraderie, the DFS player strives for the monetary prize. When one is competing with strangers, camaraderie and fun might not be significant incentives for playing. “Th[e] camaraderie simply cannot exist in a daily fantasy league where a person plays against thousands of unknown people on a website.”¹⁴⁵ The end goal of the roster is the money, and zero payoff is more likely to mean a total loss for the DFS participant.

and FanDuel, VENTUREBEAT (Sept. 10, 2015, 1:33 PM), <https://perma.cc/8YVN-RJBW>.

141. Ehrman, *supra* note 45, at 87.

142. *Pari-Mutuel Betting*, *supra* note 128.

143. Trippiedi, *supra* note 59, at 208-09.

144. *See Pari-Mutuel Betting*, *supra* note 128.

145. Trippiedi, *supra* note 59, at 221.

2. Consideration Exchanged: SFS and DFS

In a seasonal fantasy game, participants pay the entry fee as consideration to the treasurer, or to the host site. Given the intimacy of the seasonal league, it could be argued that the fee is not going to the treasurer or the host site, but to the league itself—a combined pool of funds used to incentivize competition. In return, the league allows participation in the draft, communication with other participants, and creation of a roster. While there are winners and losers, given the small payout and the intangible benefit of camaraderie, participants may all receive the same amount of intangible payoff. Furthermore, because each player knows the other players, all participants may be more willing to follow the rules.

With seasonal fantasy leagues, the treasurer or commissioner and the participants all pay, for the most part, the same consideration. Since all are participants, they all pay the entry fee. The commissioner and the treasurer have more power relative to the other participants, since they may accept or deny participants. All participants provide camaraderie to the league as a shared consideration.¹⁴⁶ To factor in the host site, it may be easier to view this as a separate contract; the league agrees to utilize the host site's resources, in exchange for following the rules and restrictions of the host site.

By contrast, with DFS games, many of the intangibles are eliminated. Players provide their cash and their patronage, nothing more. This is problematic when it comes to distinguishing DFS from illegal gambling; many courts across the country find that, when a participant provides money “in exchange for the chance of greater winnings,” that participant may be engaging in illegal gambling.¹⁴⁷ In exchange, the DFS site provides as consideration the curated information available on their website, a stake in the prize through a roster, and other website functions. Under their respective terms of use, DraftKings and FanDuel also require participants to agree to all terms—including age restrictions, refund policies, and conditions of participation—as consideration.¹⁴⁸

Because of their operations as host site-cum-commissioner-cum-treasurers, DraftKings and FanDuel demand even more consideration from participants. In their terms of use, both sites claim to hold the right to limited liability, to arbitration in a particular state (Massachusetts for Draft Kings, New York for FanDuel) in the case of dispute, and to demand return of a misplaced award.¹⁴⁹ Players, like sports bettors, can expect little in return, except for the possibility of winning the prize.

3. Differences in Competition: SFS and DFS

While both SFS and DFS utilize roster drafting, the group of opponents a participant will face depends on the game format. With traditional fantasy, a

146. Cf. Lee, *supra* note 40, at 68.

147. Edelman, *supra* note 95, at 27.

148. *Terms of Use*, DRAFTKINGS (last visited Sept. 25, 2016), <http://perma.cc/5EG2-67YZ>; *Terms of Use*, FANDUEL (last visited Sept. 25, 2016), <http://perma.cc/U2AV-Y666>.

149. *Id.*

participant will compete only against other teams in their league, usually friends, family, or coworkers.¹⁵⁰ This is likely untrue for DFS. While head-to-head style games may allow friends to compete, Guaranteed Prize Pool (“GPP”) and other formats pit the participant against a large group of other participants.¹⁵¹ For GPP games, tens of thousands of other players may be throwing in.¹⁵²

Similarly, the length of these games makes the communal aspects of SFS weaker in DFS. Seasonal leagues are designed so all teams play each other at least once. The league begins on the first day of the sport season and ends on the last day; no prizes are distributed until then.¹⁵³ But DFS starts and ends so quickly that such competition between friends is impractical. To replicate the competition of a seasonal league, a DFS player would have to compete against all her friends at the same time in a smaller league and avoid the larger jackpot games.¹⁵⁴

Time also affects the renegotiation possibilities. With most seasonal fantasy, the player acts as the team’s “general manager” and can trade or use “waiver wires” to change their lineups.¹⁵⁵ A participant thus has months to renegotiate their rosters, depending on each week’s developments. With DFS, the game is over in a day. The contestants cannot renegotiate because they join, pay entrance fees, select players, and receive prize money all in a single day.

IV. COMMUNITY ENFORCEMENT MECHANISMS AND EXTERNALITIES

A. AVINASH DIXIT AND THE SELF-GOVERNANCE CONCEPT

Of course, regulation is a formal enforcement mechanism. However, regulations may bolster the usefulness of more informal means of enforcement. To elaborate, I rely on economist Avinash Dixit’s theories of “self-enforcing,” or “community,” governance.

Self-governance works through the spread of information across the relevant community. Dixit discusses the localization of information as a determining factor; if a trader or participant in a market cheats, that information spreads to other market participants and may make those other participants less willing to contract with the cheating participant.¹⁵⁶ Individual members of the community may respond spontaneously and without coordination, but the collective toll of their actions brings “economic and psychic costs” to the violator.¹⁵⁷ “So long as information about

150. See Ehrman, *supra* note 45, at 86; see also Lee *supra* note 40, at 68.

151. See Ehrman at 107.

152. *Id.*

153. See Edelman, *supra* note 95, at 15.

154. See Trippiedi, *supra* note 59, at 221.

155. Geoffrey T. Hancock, Note, *Upstaging U.S. Gaming Law: The Potential Fantasy Sports Quagmire and the Reality of U.S. Gaming Law*, 31 T. JEFFERSON L. REV. 317, 326 (2009).

156. See generally AVINASH K. DIXIT, LAWLESSNESS AND ECONOMICS: ALTERNATIVE MODES OF GOVERNANCE 65-67 (1st ed. 2007).

157. Barak D. Richman, *Norms and Law: Putting the Horse Before the Cart*, 62 DUKE L.J. 739, 750 (2012).

cheating is accurately transmitted and preserved, a purely voluntary system of social norms can execute punishments and, therefore, can serve to deter cheating.”¹⁵⁸

Generally, informal, self-enforcing governance works better in small groups, “connected by extended family relationships, neighborhood structures, and ethno-linguistic ties, because such links facilitate repeated interactions and good communication.”¹⁵⁹ In particular, tightly-knit social networks are more conducive to such an enforcement regime. But many scholars have investigated these community enforcement mechanisms in larger communities like, for example, the cotton industry,¹⁶⁰ the diamond industry,¹⁶¹ and customer ratings for online applications.¹⁶² Below, I hypothesize relationships in each speculative activity that pose the potential for information dissemination and enforcement of norms and laws by the activity’s community.

B. POSSIBLE ENFORCEMENT CONNECTIONS IN STOCK MARKETS AND CLEARINGHOUSES

An analysis of stock markets and their enforcement regimes demonstrates some resemblance to the neighborhood structures Dixit discusses. As noted above, one of the major functions of stock exchanges is to ensure that information regarding stocks and particular companies is dispersed fairly and adequately across the market.¹⁶³ “A critical barrier that stands between issuers of common shares and public investors is asymmetric information.”¹⁶⁴

Professor Bernard Black discusses the institutions that ensure that issuers of stock—companies on stock markets—adhere to Securities and Exchange Commission (“SEC”) rules and other laws. These “reputational intermediaries” serve as a mechanism of community enforcement. Black (inadvertently or otherwise) summarizes Dixit’s hypotheses in acknowledging these mechanisms:

Among the most important institutions are reputational intermediaries – accounting firms, investment banking firms, law firms. . . . These intermediaries can credibly vouch for the quality of particular securities because they are repeat players who will suffer a reputational loss, if they let a company falsify or unduly exaggerate its prospects, that exceeds their one-time gain from permitting the exaggeration. The intermediaries’ backbones are stiffened by liability to investors if they endorse faulty disclosure, and by possible government, civil, or criminal prosecution if they do so intentionally.¹⁶⁵

His discussion, while focusing on the companies on exchanges, clearly applies to

158. Avinash Dixit, *The Empirical and Theoretical Underpinnings of the Law Merchant: Two-Tier Market Institutions*, 5 CHI. J. INT’L L. 139, 140 (2004).

159. Dixit, *supra* note 156, at 66.

160. See generally Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001).

161. See generally Lisa Bernstein, *Option Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

162. Dixit, *supra* note 158, at 141-42.

163. See discussion, *supra* notes 107-109.

164. Black, *supra* note 107, at 786.

165. *Id.* at 787.

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stock exchanges themselves. An exchange is charged with regulating itself, utilizing SEC rules and its own rules to ensure that it is operating properly, and that all companies and investors using the exchange are also operating properly.¹⁶⁶

These markets are large, and it is apparent at first glance what possibilities there are for an exchange to skirt around the rules and abuse its power. But given the community of accountants, investment bankers, lawyers, company officers and board members, members of the financial press and securities analysis professions, all of whom must follow reporting standards and adhere to the laws and regulations generated by the SEC, it seems highly unlikely, if not impossible, for a stock exchange to violate its own terms and violate federal regulations without someone finding out.¹⁶⁷ In Dixit's framework, any wrong move by a stock exchange will not only spread by word of mouth to individuals, but to entire multibillion and multitrillion-dollar industries.

Stock exchanges are often given self-regulatory organization ("SRO") status, which provides the power to regulate themselves under SEC regulations.¹⁶⁸ While this system has much potential for abuse, the tight-knit nature of the industries dealing in securities, such as investment banking, accounting, and law, provides an additional level of community enforcement to prevent abuses of SRO power.

Derivatives markets have less potential for self-regulation. Black writes of the significance of reputational intermediaries, which certainly exist in derivative exchanges, but derivatives are mostly sold over-the-counter, and thus, such intermediaries are not so important.¹⁶⁹ Part of what makes the community of stockholders and investors so strong an enforcement mechanism is the existence of *some* laws to structure the process—none of the actors want to get in trouble with the SEC.¹⁷⁰ While the Dodd-Frank Act created new clearing and reporting requirements that could facilitate some structure, whether that law and related regulations are enough to incentivize enforcement is up for debate.¹⁷¹ Proponents of CDS derivatives believe the standardization required in regulation runs counter to the unique nature of each derivative portfolio.¹⁷²

The prevalence of speculative derivatives might also weigh against strong community enforcement, both before and after Dodd-Frank. They "create perverse incentives for market participants to destroy social value for the purposes of receiving investment returns."¹⁷³ There are a handful of gigantic players that dominate derivatives trading. Because market participants need not hold any of the financial instruments packaged in a CDO or CDS, their interest in the CDS may be

166. Dana Atwood Lukens, *Regulation for the Securities Markets?*, 10 ANN. REV. BANKING L. 379, 384-85 (1991).

167. See Black, *supra* note 107, at 789-99 (Black provides a list of "core" institutions he believes are most important in developing strong securities markets and countering information asymmetry.).

168. Lukens, *supra* note 166, at 384-85.

169. Black, *supra* note 107, at 787.

170. See discussion *supra* notes 164-168.

171. See discussion *infra* notes 204-212.

172. See O'Connor, *supra* note 118, at 576.

173. See Charap, *supra* note 126, at 140.

negative—they would want the instrument to fail so that they may profit.¹⁷⁴ Even those with an interest in said financial instruments might desire them to fail if they have purchased CDS protection in excess of the value of said instruments.¹⁷⁵

C. WEAK CONNECTIONS IN PARI-MUTUEL GAMBLING

Like these other speculative operations, pari-mutuel wagering faces certain community enforcement mechanisms. Regardless of whether on or off-track, or off or online, pari-mutuel wagering faces tough competition from other gambling options that may entice bookies and sportsbooks to play fair. With more ways to gamble at casinos and online—including cheaper, illegal, offshore sportsbooks—there are more ways for sportsbooks to lose players, especially if the books err in their ways.¹⁷⁶ For OTB sportsbooks, many of which contract with the tracks to allow remote wagering, questionable behavior may cause them to lose those contracts.¹⁷⁷ For trackside betting operations, questionable behavior may lead to lower attendance and thus hurt the track itself.¹⁷⁸

Unlike the other examples, however, there are far fewer players that interact with a pari-mutuel operation, and therefore there is likely less community enforcement. Bookies and sportsbooks interact with government regulators and enforcement, the players, and sometimes the track. They also pose externality issues for horse breeders and racers. Government regulation of sportsbooks is very strong,¹⁷⁹ and may be sufficient to prevent mischievous conduct by the books. But unlike securities exchanges, there are fewer eyes watching each transaction and each distribution of prizes; information may spread less quickly, if at all, across players. Without direct government oversight, it is unlikely any information of wrongdoing by the book will become known.

D. SEVERAL SOURCES OF ENFORCEMENT IN ALL FANTASY SPORTS

1. Sports Networks and Leagues as a Double-Edged Sword

As noted earlier, Fox Sports, Major League Baseball (“MLB”), ESPN, the National Basketball Association (“NBA”), Comcast, the National Broadcasting Company (“NBC”), Google, the Dallas Cowboys, the New England Patriots and many other companies have substantial ownership stakes, advertising deals, or likewise with either DraftKings or FanDuel.¹⁸⁰ At the same time, the major sports

174. See *id.* at 141.

175. *Id.* at 142.

176. See Matthew Gallagher, Note, *The Changing Face of the “Sport of Kings,”* 19 SPORTS L.J. 275, 283 (2012) (“[I]n these tough economic times, prospective gamblers have spread their discretionary dollars over a larger number of options, if they have even gambled at all . . .”).

177. See Anthony Cabot, *The Absence of a Comprehensive Federal Policy Toward Internet and Sports Wagering and a Proposal for Change*, 17 VILL. SPORTS & ENT. L.J. 271, 280 (2010).

178. See Anthony N. Cabot & Louis V. Csoka, *The Games People Play: Is it Time for a New Legal Approach to Price Games?* 4 NEV. L.J. 197, 210 (2003-2004).

179. See generally Hurt, *supra* note 30.

180. Drape & Williams, *supra* note 1.

leagues have universally come out against sports gambling – the MLB, NFL, and NBA all participated in lobbying for PAPSA.¹⁸¹

This dynamic makes for a very hazy relationship between the sports leagues, networks and fantasy sports providers, especially in the current legal climate. With the New York State Attorney General engaging in a suit against two companies in which so many sports networks have invested—no less, in a state which many of these sports networks and leagues call home—a huge chunk of the sports entertainment industry now has a direct financial stake in the outcome of the New York litigation.¹⁸² With 12.8 percent of the entire United States daily fantasy sports market in New York, a total ban on daily fantasy sports could have a permanent toll on these companies.¹⁸³ So on one hand, all of these parties may fight for *fewer* restrictions on daily fantasy sports: less regulation.

On the other hand, many sports organizations and politicians believe that sports gambling harms the integrity of their games. This could provide incentive for sports networks and leagues to whip daily fantasy sports into shape. When New Jersey governor Chris Christie attempted to legalize sports betting in the state, the National Basketball Association, the National Hockey League, Major League Baseball, the National Collegiate Athletic Association, and the NFL all filed suit against the state to halt Christie’s actions.¹⁸⁴ To deter its own players from participating in a gamble or accepting a bribe, NFL collective bargaining agreements have included an “integrity of game” clause that allows the NFL to permanently terminate any player who so much as associates with gamblers or gambling activity.¹⁸⁵ Because these leagues and networks also hold tremendous power over DFS operators through their ownership stakes, they have the power to ensure DFS operators stay within the law, and can threaten them with hostile takeover, divestment, ending of sponsorship deals, and more.

2. Difficulties of Self-Regulation

Other than corporate pressures, sites like DraftKings and FanDuel can only rely on themselves to make sure customers are not harmed. These sites detail extensive terms of use including who may use the sites, when the sites may be used, and how they may be used.¹⁸⁶ According to the terms of use, a player must be at least 18 years of age to play. Categories of people prohibited from entering a contest include: employees of the company or immediate family members of said employees; employees of any competing fantasy site and any immediate family member; employees of any sports governing body that has access to privileged information or

181. Edelman, *supra* note 95, at 37.

182. Drape & Williams, *supra* note 12.

183. *Id.*

184. *Pro Leagues, NCAA Poised to Sue N.J. Over Sports Betting*, USA TODAY (Dec. 22, 2012), <http://perma.cc/Z9MD-3RA3>.

185. See Vacca, *supra* note 24, at 15-16.

186. *Terms of Use*, DRAFTKINGS (last visited Sept. 25, 2016), <http://perma.cc/5EG2-67YZ>; *Terms of Use*, FANDUEL (last visited Sept. 25, 2016), <http://perma.cc/U2AV-Y666>.

is barred from participating in sports bets.¹⁸⁷ These are only a few of the myriad rules designed to protect participants from rule-breakers.

However, these sites are black boxes. Their means of self-regulation are entirely opaque to players, regulators, or other interested parties. Regardless, the methods they have imposed for self-enforcement have not proven entirely effective. To sign up, DraftKings only requires that a person enter their date of birth and check a box assuring that they are, indeed, 18 or older. Registration otherwise requires only credit or debit card information and a billing address.¹⁸⁸ It would not only be feasible, but in fact easy for an underage person to use the site. In terms of enforcing the employee ban on participation, we need only look at the employee who won \$350,000 by playing at another site—and thus launched litigation and statewide bans.¹⁸⁹

There are some other market factors that may affect the operation of these sites. Other sites besides FanDuel and DraftKings offer the DFS experience; players can always take their money elsewhere.¹⁹⁰ If a DFS participant plays for the quasi-gambling element, they could always switch to an actual sports book (illegal or legal) or play legalized forms of gambling if these sites prove to be no longer trustworthy. Participants who are in it for fun or camaraderie can always move offline or to websites that allow seasonal play. These market factors also prevalent in stock exchanges, sports gambling, and most other markets, are not unique.

Seasonal fantasy sports have a much stronger sense of community and personal enforcement than DFS. Because most of the league players are personally acquainted with the other participants, and because the league commissioner and treasurer are likely among this group, these strong interpersonal ties provide a disincentive from cheating the system – any foul play is a foul play against friends.¹⁹¹ Even when most of the commissioner and treasurer duties are handed over to the host site, because payoffs for seasonal sports are lower and leagues are smaller private affairs, there is a stronger communal aspect to SFS, and therefore, stronger potential for community enforcement than DFS.

V. STATUTORY AND REGULATORY ENFORCEMENT

A. STOCK EXCHANGES AND THE SRO

The SEC is the rule-making authority for stock markets. Exchanges are regulated

187. *Id.*

188. *See id.*

189. Drape & Williams, *supra* note 1.

190. These other sites include Draftpot, Draftday, Victiv, StarsDraft, and FantasyHub, just to name a few, although all of these others hold much less market share than FanDuel or DraftKings.

191. *See* discussion, *supra* notes 146-148; *see also* Lee, *supra* note 40, at 68 (“Players involved in fantasy leagues often follow their favorite sports more intimately, such that fantasy sports provide these players with a form of entertainment beyond the casual observer. Many fantasy leagues are ‘comprised of life-long friends and relatives, where group size is limited by the number of close friends,’ and ‘friendship and the maintenance of ties’ forms a greater part of the experience than ultimately who ends up winning the league. In fact, one fantasy player has noted that he participates in the leagues ‘mostly for the camaraderie,’ as it allows him to keep in touch with former high school friends located all over the country.”)

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pursuant to § 6 of the Securities Exchange Act of 1934.¹⁹² A stock exchange can only operate if it has been registered with the SEC under the 1934 Act.¹⁹³ However, the SEC is not the only party that enforces the rules or regulates stock markets. In fact, stock markets are often charged with regulating themselves.

Self-regulatory organizations (“SROs”) are “privately funded entities that carry out quasi-governmental activities to regulate the securities markets.”¹⁹⁴ In other words, they are stock exchanges that make and enforce their own rules. These SROs include FINRA (formed by a merger of NASD and NYSE), NASDAQ, the Chicago Stock Exchange, and the International Securities Exchange.¹⁹⁵

To provide an example, NYSE has been charged, as an SRO, with enforcing rules and regulations generated by the SEC, the Securities Exchange Acts, and by itself.¹⁹⁶ Its own rules must be “designed to prevent fraudulent and manipulative practices and to protect investors and the public interest.”¹⁹⁷ A failure to comply with its duties can be met with sanctions and even revocation of SRO status.¹⁹⁸ All brokers and dealers are only allowed to deal on registered exchanges; they themselves must also be registered.¹⁹⁹

It could be problematic to give a company like NYSE the responsibility of keeping itself within the law. “As private entities, SROs also conduct acts that are non-regulatory—they are committed to promoting their business interests, increasing profits and trading volume, and administering and managing business affairs.”²⁰⁰ A privately owned exchange has profit motives that could potentially conflict with its duty to weed out corruption in the market. In light of our comparison of stock exchanges to sports gambling, it seems even stranger that the former would be allowed to regulate itself, while the latter is largely banned outright.

Self-regulation may be, if anything, a “compromise born of practicality” rather than a laissez-faire approach to a multitrillion-dollar industry.²⁰¹ The sheer number of businesses trading on the stock markets, the number of stock markets operating in the United States, and the amount of money flowing through any one particular exchange, when compared to the diminutive size of the SEC (under 4,000 employees), points to the need for the self-regulatory system.²⁰² A system requiring the government to generate all controls in the securities market would be problematic at best. “Given the necessity of quick regulatory reaction to market changes, direct government regulation would have been ineffective due to the inherent slowness of government regulatory agencies.”²⁰³

192. THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION*, 10-11 (6th ed., 2009).

193. Ellis et al., *supra* note 102, at 112-13.

194. Jennifer M. Pacella, *If the Shoe of the SEC Doesn't Fit: Self-Regulatory Organizations and Absolute Immunity*, 58 WAYNE L. REV. 201, 207 (2012).

195. *Id.*; see also Lukens, *supra* note 77, at 384.

196. Ellis et al., *supra* note 102, at 112-13.

197. *Id.* at 112.

198. *Id.*

199. Lukens, *supra* note 77, at 385-86.

200. Pacella, *supra* note 194, at 207.

201. Lukens, *supra* note 77, at 385.

202. SEC. AND EXCH. COMM'N, CONGRESSIONAL BUDGET JUSTIFICATION: FY 2014, at 12 (2014).

203. *Id.*

1. Regulation of Derivatives and Clearinghouses

The Dodd-Frank Act refurbished the derivatives controls of the Commodity Futures Modernization Act by effectively transplanting the SRO model of regulation to clearinghouses. The Act requires active market participants to register with the SEC or the Commodity Futures Trading Commission (“CFTC”), and requires all standardized OTC derivatives to be “cleared, traded on an exchange or exchange-like platform, reported to data repositories, and publicly reported.”²⁰⁴ Under the law, both the SEC and CFTC have split authority over the derivatives market,²⁰⁵ but the clearinghouses are also self-regulatory organizations, so they are able to write and enforce rules on their members under the authority and oversight of both agencies.²⁰⁶

Because most OTC derivatives trades were previously made without the use of clearinghouses, Congress added a mandatory clearing requirement, sending all qualifying swaps through CCPs to “reduce systemic risk . . . putting OTC transactions on the books of regulated clearinghouses”²⁰⁷ Part of this clearing process will require participants in the trade to post a cash balance with the CCP to guarantee that all investments are backed up with adequate capital.²⁰⁸

The effectiveness of this regulatory structure is up for debate. While derivatives trading has become more transparent, now that all qualifying trades must go through a regulated CCP, the cost of market participation is very expensive, requiring registration, capital maintenance, and other costly measures.²⁰⁹ Coverage by both the SEC and CFTC puts market participants in a position where they may have to comply with conflicting sets of rules depending on what derivatives they trade.²¹⁰ Moreover, given the international nature of the derivatives market, some trades may be simply shifting off the grid. “The major banks had tweaked a few key words in swaps contracts and shifted some other trades to affiliates in London, where regulations are far more lenient.”²¹¹ However, this balance might change after an agreement between the CFTC and the European Union in February of 2016 created a common set of requirements in CCP regulation.²¹²

204. Hester Pierce, *Derivatives Clearinghouses: Clearing the Way to Failure*, 64 CLEV. ST. L. REV. 589, 598 (2016).

205. Dan M. Berkovitz, *Swaps Provisions of Dodd-Frank Act: Cost-Benefit Analysis and Judicial Review*, BANKING & FIN. SERVS. POL’Y REPORT (Sept. 2014).

206. Pierce, *supra* note 204, at 611.

207. Carney Simpson, *Do End-Users Get the Best of Both Worlds? Title VII of Dodd-Frank and the End-User Exception*, 69 WASH. & LEE L. REV. 1759, 1782-83 (2012).

208. *Id.* at 1783.

209. Luke Zubrod, *Four Years Later: Dodd-Frank and Derivatives*, INSTITUTIONAL INVESTOR (Aug. 1, 2014), <http://perma.cc/KJ3Z-XXB8>.

210. *Id.*

211. Charles Levinson, *U.S. Banks Moved Billions of Dollars in Trades Beyond Washington’s Reach*, REUTERS (Aug. 21, 2015), <http://perma.cc/9C4M-E4PX>.

212. Liz Moyer, *U.S. and Europe Set Rules for Derivatives Regulation*, N.Y. TIMES, Feb. 11, 2016, at B3, available at <http://www.nytimes.com/2016/02/11/business/dealbook/us-and-europe-reach-agreement-on-derivatives-regulation.html>.

B. PARI-MUTUEL BETTING'S NEAR-TOTAL FEDERAL BAN

Formal and informal sports betting are heavily restricted across the board. Save for a few spare exceptions, one cannot bet on football, baseball, basketball, or soccer games, among others.²¹³ Even something as innocuous as an NCAA March Madness pool constitutes illegal gambling.²¹⁴ A number of federal laws ensure this.

The 1961 Wire Act prohibits people from knowingly using any wire communication, or “any and all instrumentalities, personnel, and services,” for the purpose of relaying betting information or bets on any sports event.²¹⁵

The 1970 Illegal Gambling Business Act and Racketeer Influenced and Corrupt Organizations Act (“RICO”) serves “to assist the several states in the enforcement of their laws pertaining to gambling,” including enforcement of state gambling laws.²¹⁶

The 1992 Professional and Amateur Sports Protection Act (“PAPSA”) made it unlawful for “a government entity to sponsor, operate, advertise, promote, license, or authorize, by law or compact . . . a lottery, sweepstakes, or other betting, gambling, or wagering scheme”²¹⁷ PAPSA grandfathered in exceptions for pari-mutuel animal racing, and certain other legal forms of sports gambling.²¹⁸ Only Oregon, Delaware, Montana, and Nevada are currently exempt from PAPSA’s restrictions.²¹⁹ PAPSA was passed “(1) to stop the spread of state-sponsored sports gambling, (2) to maintain sports’ integrity, and (3) to reduce the promotion of sports gambling among America’s youth.”²²⁰

The 2006 Unlawful Internet Gambling Enforcement Act (“UIGEA”) makes it unlawful for financial institutions to facilitate payment transactions between offshore gambling operations and American customers. It called for regulations, placed upon financial transaction providers, mandating them to implement measures to identify and block prohibited gambling transactions – a sort of self-regulation system in itself.²²¹

The federal laws together do not outright ban sports gambling. They only make it illegal to gamble over the phone, across state lines, or for the government to get at all involved with a bookie.²²² The rest is mostly dependent on state law. The

213. See generally Vacca, *supra* note 24.

214. Hancock, *supra* note 155, at 319.

215. Goeller, *supra* note 37, at 2-3.

216. *Id.* (quoting *United States v. Yaquina*, 204 F. Supp. 276, 277 (N.D.W. Va. 1962)).

217. 28 U.S.C.A. § 3702.

218. Goeller, *supra* note 37, at 4.

219. Vacca, *supra* note 24, at 4 (PAPSA exempted any state with a “betting, gambling or wagering scheme in operation . . . at any time during the period beginning January 1, 1976 and ending August 31, 1990,” as well as betting schemes authorized by statute prior to October 2, 1991. Only Oregon, Delaware, Montana, and Nevada met this standard.).

220. Eric Meer, Note, *The Professional and Amateur Sports Protection Act (PASPA): A Bad Bet for the States*, 2 UNLV GAMBLING L.J. 281, 288 (2011).

221. Ryan M. Rodenberg & Anastasios Kaburakis, *Legal and Corruption Issues in Sports Gambling*, 23 J. LEGAL ASPECTS SPORT 8, 15 (2013).

222. Vacca, *supra* note 24, at 3-6. While PAPSA did effectively ban sports gambling in most states, the language of the statute was not a flat ban. As Vacca explains, any state that had a gambling scheme in operation between 1976 and 1990 was allowed to continue operating. However, only four states had

Interstate Horseracing Act determined that “the states should have the primary responsibility for determining what forms of gambling may legally take place within their borders.”²²³ One exception remained for interstate off-track horse race betting: Congress would allow such wagers, but would regulate it as interstate commerce.²²⁴

1. The New York Example

Because New York State is at the center of fantasy sports controversy, we should look to how the state handles sports gambling. The only legal sports gambling in New York is horse racing. Horse racing in the state, as well as reservation gaming and video gaming, is overseen and regulated by the New York State Gaming Commission.²²⁵ The Gaming Commission, formed in 2013 as a merger of the NYS Racing and Wager Board and the New York Lottery, consists of five members who have oversight on the state’s racetracks and five off-track betting locations.²²⁶ It has the singular power to “approve all systems used for data processing and communications in the operation of pari-mutuel betting.”²²⁷ As it stands, all corporations that hope to offer pari-mutuel betting must be licensed to do so by the Gaming Commission and pay a \$500,000 bond.²²⁸ These corporations must also maintain a book of all bets, which may be examined at any time by the New York Department of Taxation and Finance.²²⁹

The state legislature also incorporated five off-track betting (“OTB”) corporations, one for each region of the state (except for New York City).²³⁰ The legislature granted the officers and directors of each of these corporations the power to hire police officers to enforce gambling and other laws on their properties.²³¹ However, the Gaming Commission still received general jurisdiction over all OTB facilities, and as with on-track gambling corporations, the Gaming Commission was granted the power to establish general regulations for the facilities.²³²

New York’s arrangement allows some operation under heavy state supervision—not too far off from what the SEC has set up through SRO registration and regulation. Both require participants to register with the main lawmaking body. Both involve some degree of self-enforcement.

Whether or not the online iteration of horse race betting is legal is, surprisingly, uncertain. While the Justice Department claims interstate horse race wagering is illegal, the WTO concluded that it is illegal for the United States to prohibit foreign horseracing corporations from operating in the United States, when the United States

such schemes – Oregon, Nevada, Montana, and Delaware.

223. 15 U.S.C.A. § 3001.

224. *Id.*

225. NEW YORK STATE GAMING COMMISSION, <http://gaming.ny.gov> (last visited Sept. 24, 2016).

226. *Id.*

227. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 112 (McKinney 2013).

228. *See id.* §§ 232, 233.

229. *See id.* § 239.

230. *See id.* § 502.

231. *See id.* § 504.

232. *See id.* § 520.

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has legal domestic operations.²³³ There are currently a number of state-licensed operators that accept online wagers from customers in the twenty-nine or so states that allow horse race wagering.²³⁴

C. FEDERAL FANTASY REGULATION

Daily fantasy sports are exempted from federal antigambling laws.²³⁵ The UIGEA asserts that a bet or wager, illegal under the law, does not include:

Participation in in any fantasy or simulation sports . . . 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 . . . and . . . (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.²³⁶

As long as fantasy sports websites predetermine their jackpots, refuse to allow participants to rest their game entirely on the performance of one athlete or team, and make participants rely on their “skill,” they will not be considered illegal under UIGEA. This “skill” determination is incredibly shaky however, and Christine Hurt completely rejects the paradigm requiring a definitive classification of a game as one of chance or of skill, instead advocating for a spectrum of speculation between chance and skill.²³⁷

Other laws that have universally barred online sports gambling have not been applied to fantasy sports. In spite of the 1961 Wire Act, no cases have applied the Act to fantasy sports leagues.²³⁸ There is no indication that any fantasy sports companies have fallen under the broad ban of the Illegal Gambling Business Act.²³⁹

VI. THE REGULATORY SOLUTION

Based on the observations in the preceding sections, there are clear similarities between all four activities. However, pari-mutuel wagering is crushingly regulated, most sports betting is simply illegal, and stock and derivatives trading is heavily regulated but with much authority given to the exchange corporations to govern

233. Joseph M. Kelly, *U.S. Land-Based and Internet Gambling: Would You Bet on a Rosy Future?* 17 VILL. SPORTS & ENT. L.J. 339, 351-52 (2010).

234. *Id.*

235. Edelman, *supra* note 95, at 37.

236. 31 U.S.C.A. § 5362(1)(E)(ix) (2006).

237. *See generally* Hurt, *supra* note 30.

238. Edelman, *supra* note 95, at 35.

239. *Id.*; *see also* 18 U.S.C. § 1955(b)(iii).

themselves. The fourth activity, fantasy sports, remains up in the air. A number of states have passed new laws to control DFS. Whether these laws will effectively protect DFS players and prevent DFS provider mischief has not yet been determined.

One possible path these regulations could take is to consider these similarly speculative activities and devise a control mechanism with borrowed parts. Where DFS most resemble securities trading, controls borrowed from securities laws might effectively control DFS providers; or where DFS most resembles pari-mutuel gambling, restrictions or even outright bans might provide the best treatment. In this section, I advocate for the most useful controls of DFS, and then compare these suggestions to recently implemented state legislation to re-legalize the DFS industry.

A. A HYPOTHETICAL FRAMEWORK FOR LAWMAKING

The preceding sections suggest a regulatory scheme that accounts for the following: (1) strongly centralized and highly curatorial design of fantasy sports competitions, (2) short-term involvement and low consideration between participants and providers, and (3) pervasive community enforcement measures through sports leagues and media, would best suit re-legalization of the DFS industry.

DFS providers are highly centralized, controlling and holding the funds for everyone rather than connecting buyers to sellers. Funds are held until payoff. Like a stock exchange, DFS does not work without the central entity. Unlike a stock exchange, but like pari-mutuel wagering, the provider is the master of the money.²⁴⁰ Thus, legislation or regulation should ensure that winnings are fairly and timely paid and that no funds are being siphoned off by the provider. Oversight should focus on the internal operations of the DFS site, protecting the public from possible wrongdoing by the provider.

Similarly to securities trading and unlike gambling, the DFS industry is heavily influenced by media and sports league beneficiaries, which ensure that providers do not break the law or harm participants.²⁴¹ However, besides these entities that are really external from the DFS industry itself, there is little reason for a DFS provider to follow the law and norms except to match up with the competition. Laws to control DFS should be designed to maximize community enforcement, with penalties for companies or parties that help interfere with lawful operation or measures to create substantial transparency in the operation of the sites. At the same time, strong oversight of the industry itself could still be necessary. A regulatory scheme that welcomes the participation of new DFS companies would encourage competition and thus ensure that DFS providers follow the law, or risk losing users.

Given the short duration of the games and the massive participation, focus on the individual participants is impractical. Likewise, it is not clear how much an individual participant could cheat when the rules are created and the outcome monitored by a distant company.²⁴² The old paternalistic approach to gambling, which focused on moralistic concerns, may be necessary to implement in small

240. See discussion, *supra* notes 162-178.

241. See discussion, *supra* notes 180-185.

242. See discussion, *supra* notes 95-101.

amounts to ensure players do not go overboard with participation. For example, limitations on the number of times a player may enter a single contest may make up for the lack of real renegotiation ability in each entry.²⁴³ However, as the DFS controversy last year revealed, the biggest threat to individual players may come from within the DFS providers themselves. Likewise, it may be easier and less expensive to monitor the providers' operations game-to-game, and the activities of their employees and affiliates, rather than root out individual players.

The control mechanism must also account for one truly unique characteristic of DFS providers – their extra role as curator of the information and statistics on their websites. Unlike stock trading and gambling, fantasy sports competitions are dictated by the rules and publication of statistics on the providers' websites; a player's statistics only matter to a fantasy sports contestant if those statistics are reflected in the contest itself. Fantasy sports websites control what goes into the competition, and therefore the competition itself.²⁴⁴ Stock traders may have access to privileged information, but their job is not to inform investors of this information, nor to determine whether that information has any influence on stock price.²⁴⁵ DFS providers have access to this information and determine whether it matters to the contest. To fix this potential problem, regulations should push toward normalizing the statistics of each contest across all fantasy sports providers, thus making sure every website releases the same information in the same way.

In short, laws should replicate the self-regulating character of stock and derivatives exchanges with heavier scrutiny of the internal operations of each provider. The oversight should ensure close watch of each contest – the cash flows, the play of game, the publication of information, completion, and payout. The laws should focus on protecting the public from deviant DFS providers and their affiliates, not necessarily from other players.

B. STATE REGULATION: NEW YORK AND MASSACHUSETTS

Recently, several states have moved to bring DFS operators back in line with the law. I focus on both New York's new statute and Massachusetts's regulation because these states are home to FanDuel and DraftKings, respectively. New York is also one of the most significant markets for the future of DFS, so my focus remains on the Empire state.²⁴⁶ On August 3, 2016, New York became the eleventh and most populous state to enact a new law regulating DFS,²⁴⁷ codified in the New York Racing, Pari-Mutuel Wagering & Breeding Law.²⁴⁸ On July 1, 2016, Massachusetts Attorney General Maura Healey finalized a set of regulations to set the rules for future DFS operations.²⁴⁹ Massachusetts Governor Charlie Baker signed these

243. See *id.*

244. See Edelman, *supra* note 95, at 19-21.

245. See discussion, *supra* notes 107-111.

246. Rios, *supra* note 13.

247. Edelman, *supra* note 17.

248. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law §1400 (2016).

249. *The Sports Xchange, DraftKings, FanDuel help Massachusetts ban daily fantasy players under 21*, UNITED PRESS INTERNATIONAL (Mar. 25, 2016, 3:55 PM), <https://perma.cc/T559-HBST>.

regulations into binding law on August 10, 2016.²⁵⁰

The Massachusetts and New York laws are not ideal because the bulk of their text concerns the conduct of individual players. They may have been drafted with abusive players in mind: “DraftKings and FanDuel pushed the concept into overdrive, allowing anyone to create multiple lineups with the possibility of playing (and winning) every day. Some players even used custom-built data models and analytics software to improve their odds of winning.”²⁵¹ However, these fears ignore the insider controversy that caused DraftKings and FanDuel to be shut down in the first place, thus controlling the gamers but not the game itself. The protections in the laws may not be enough to prevent abuses by the providers themselves.

The New York law first clarifies that DFS is *not* a game of chance, but rather a game of skill, and therefore “does not constitute gambling” in New York.²⁵² In Massachusetts, “nothing in this regulation may be interpreted as authorizing a wager, bet, or gambling activity that is prohibited by law,” suggesting that the DFS contests mentioned in the regulation are *not* gambling.²⁵³ The New York law prohibits a large class of people from participating, including employees or agents of any DFS provider, any family member of any employee or agent, any athlete included in DFS statistics, any person involved with any sporting events connected to DFS, anyone who lives in a state where DFS is prohibited, and anyone under the age of 18.²⁵⁴ The Massachusetts regulation is identical, except for the significant addition of proxy restrictions; none of the class of banned individuals is allowed to play via a proxy participant.²⁵⁵ The New York statute gives authority to the Gaming Commission to permit new DFS providers and create regulations to fulfill the law.²⁵⁶

Section 1404 of the New York statute, and several subsections of the Massachusetts Regulation,²⁵⁷ concern all of the safeguards each DFS provider must follow, focusing on restrictions on who can play, when, and how often. They require each DFS provider to forbid any player from having more than one “active and continuously used” account with a particular provider.²⁵⁸ They require particular guidelines to prevent minors from playing and identification of all “highly experienced players in any contest.”²⁵⁹ They require restrictions on the number of entries a particular player may put into each contest, and demand that each site “offer introductory procedures for authorized players . . . that explain contest play and how

250. Jordan Graham, “Charlie Baker makes daily fantasy sports legal,” BOSTON HERALD (Aug. 11, 2016), <https://perma.cc/V9HW-4M9A>.

251. Davey Alba, “Daily Fantasy Sports Win the Startup Bowl Against New York,” WIRED (Aug. 4, 2016), <https://perma.cc/4V3S-HTW2>.

252. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1400(B)(2) (2016).

253. Mass. Bill 940 C.M.R. 34.02 (2016).

254. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1401(13) (2016).

255. Mass. Bill 940 C.M.R. 34.12(1) (2016).

256. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1402(2), (6) (2016).

257. See Mass. Bill 940 C.M.R. 34.04-06, 34.10 (2016).

258. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1404(1)(A) (2016); Mass. Bill 940 C.M.R. 34.06(1) (2016).

259. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1404(1)(G) (2016); Mass. Bill 940 C.M.R. 34.12(11) (2016).

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to identify a highly experienced player.”²⁶⁰ The New York law mandates prominently displayed information on treatment for gambling addiction, methods to prevent novice players from competing with experienced players, and limitations on the cash amount any one person can play.²⁶¹ These are paternalistic measures that do not invoke the concerns for bad behavior on the part of DFS providers, so much as they reflect the same moralistic fears that led to gambling prohibitions. The Massachusetts regulation contains much of the same, although with more specific procedures and requirements for DFS providers to fulfill.²⁶²

In New York, there are some provisions that ensure a DFS provider is able to pay out prizes and not back out of its obligations to winners. Registered DFS sites must establish and make public the amounts of any prizes or awards before the contest begins.²⁶³ Sites must deposit all players’ funds into a segregated account to protect them from insolvency.²⁶⁴ These requirements make sure the cash flows of each DFS site remain in line, although it is not clear from the law whether the Gaming Commission will consistently monitor these funds. The law states that each registrant shall submit annual reports to the Gaming Commission including total entry fees paid, prizes awarded, and more such information; and grants the Commission authority to audit any registered DFS site at any time.²⁶⁵ The Massachusetts regulation has similar provisions, but provides deeper detail on how to segregate player funds from the company coffers, suggesting, for example, that DFS providers place the funds in a “special purpose Segregated Account that is maintained and controlled by a properly constituted corporate entity that is not the [DFS provider].”²⁶⁶

The New York and Massachusetts laws are not good matches to the hypothesized mechanism, although they may be padded with more regulation in the future. The New York statute grants to the Commission the power to execute the laws, but provides little guidance on how to enforce the laws or, more importantly, how to monitor operators to ensure compliance. It is not clear if Massachusetts’s regulation even has oversight from such a committee; the regulation suggests only that the Attorney General enforces the rules.²⁶⁷

The New York and Massachusetts laws do not properly recognize the ability, or rather inability, of each DFS provider to monitor itself, nor do they try to generate any self-regulatory system among the individual providers. At the same time, both demand providers to self-report and focus on the behavior of individual players, rather than control their own operations. There is no viable method to ensure proper oversight, and the efforts of the providers and the Gaming Commission in New York, or the Attorney General in Massachusetts, are likely concentrating on the wrong

260. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1404(1)(F) (2016).

261. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1404(M) (2016).

262. See Mass. Bill 940 C.M.R. 34.04-06, 34.10 (2016).

263. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1404(N) (2016).

264. *Id.* at § 1404(L).

265. *Id.* at § 1406(2).

266. Mass. Bill 940 C.M.R. 34.05(2) (2016).

267. See generally Mass. Bill 940 C.M.R. 34.00 (2016).

problem.

Moreover, in New York, the statute creates no controls for the curatorial side of DFS, except for disclosure of prizes, participation, and “highly experienced players.”²⁶⁸ By contrast, the Massachusetts regulation includes a subsection handling “non-public information” in a DFS contest.²⁶⁹ It punishes any DFS providers that “shall knowingly permit an athlete, sports agent, team employee, referee or league official to provide proprietary or non-public information to any DFS player”²⁷⁰ and commands those providers, on discovery of a violation, to terminate promotional agreements with the violators, including athletes and league officials.²⁷¹ Massachusetts’ regulation covers a potential community enforcement mechanism that is sorely missing in the New York statute.

One specific provision in the New York law may even be detrimental to market competition, which could provide much-needed community enforcement. In requiring all DFS operators to apply for registration with the Gaming Commission, the law creates a carve-out, allowing “any operator that was offering contests to persons located in New York State prior to the Tenth of November, Two Thousand Fifteen” to continue operating while awaiting acceptance or rejection of their registration.²⁷² Notably, that date marks the day New York Attorney General Eric Schneiderman sent cease-and-desist letters to FanDuel and DraftKings.²⁷³ Given the two companies’ gigantic share of the DFS market, the statute gives the two companies a massive head start against competitors that might have been launched after November and could harm competition. The New York statute does not contain the kind of controls that would best prevent wrongdoing on the part of DFS providers.

CONCLUSION

I have conducted analysis, rooted in basic law and economic theory, to propose new considerations in the drafting of DFS industry regulation. While there is no truly clear answer for how best to regulate the industry, it is clear that one of DFS’s biggest weaknesses comes from within. The only proper way to solve this problem is by regulating the innards of these companies. A policing system should be used to ensure that employees are not using privileged sports information to win big with other DFS providers; to make sure the sites are fairly handling entry fees and distributing awards; and to check for conflicts of interest between participants, DFS sites, and the sports leagues that sponsor them.

As the recent rules in New York and Massachusetts suggest, however, new regulations are *not* taking this direction. Lawmakers target outsider cheaters and users, when the problems that led to the banning of DFS operations stemmed from

268. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1401(6) (2016).

269. Mass. Bill 940 C.M.R. 34.12(5) (2016).

270. *Id.*

271. *Id.* at (5)(a).

272. N.Y. Racing, Pari-Mutuel Wagering and Breeding Law § 1402(1)(B) (2016).

273. Dustin Gouker, *The Law of Unintended Consequences for New York Fantasy Sports Regulations*, LEGAL SPORTS REPORT (August 5, 2016, 11:13 AM), <https://perma.cc/EEA4-9QN6>.

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the actions of website employees. Whatever policies were originally in place were weak enough to allow an employee to win more than a quarter million dollars on privileged information. As most states remain agnostic on the regulatory stance of fantasy sports, when the time comes to debate new law, they should consider the original source of controversy, the operational functions of the site that might facilitate control, and the interest of users to be protected not from other players, but from the sites themselves.