

Tips For Fantasy Sports Cos. As State AGs Target Industry

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Selecting the roster of your fantasy football team can be a maddening exercise. You could spend hours analyzing running backs' carries per game, yards-per-carry averages, and weighing your pass protection concerns against injury risk. But, as they say, on any given Sunday anything can happen. Your chosen running back could get injured in the first quarter, or make a huge completion only to have the play called back because of a minor penalty committed by a teammate on the other side of the field.

In a season-long fantasy sports league, your strategy might hold up over the course of the season despite one bad game. You could make a trade or bench your underperformers. But, in a one-day league, you're out of luck. A bad bounce, a rain-slick field, even a gust of wind can frustrate the most carefully chosen lineup — and mean the difference between winning big or walking away with nothing at all.

This is exactly the argument recently made by lawyers from the office of New York Attorney General Eric Schneiderman in a New York state courtroom, when they successfully sought a preliminary injunction to stop fantasy sports industry giants DraftKings Inc. and FanDuel Inc. from operating in New York. Schneiderman issued cease-and-desist letters to DraftKings and FanDuel on Nov. 10, 2015, ordering the daily fantasy sports giants to stop accepting deposits from New York residents and declaring that the games constituted illegal gambling causing “the same kinds of social and economic harms as other forms of illegal gambling.”[1]

The cease-and-desist letters were quickly followed by actions filed by Schneiderman in New York state court, seeking court orders directing the companies to cease accepting deposits from New York residents.[2] The companies opposed Schneiderman's request for preliminary injunctions, arguing that they should be allowed to continue to operate until the case goes to trial. Both companies filed separate actions in state court, asking the court to rule that their operations are legal under New York law.[3]

On Dec. 11, New York State Supreme Court Judge Manuel Mendez issued a ruling on Schneiderman's request and imposed a preliminary injunctions enjoining and restraining the two companies from "doing business in the state of New York, and from accepting entry fees, wagers or bets from New York consumers." Judge Mendez noted that the decision is "not a final determination of the merits and rights of the parties." In fact, it was not even a final determination for that day, since a few hours later a New York state appellate court issued an emergency stay which allows the sites to continue to operate — at least until Jan. 4, 2016.

In his court filings, Schneiderman claims that DraftKings received substantial entry fees from users in states where the company does not operate because daily fantasy sports are considered illegal gambling. Schneiderman also claims that both DraftKings and FanDuel allowed their employees to play on each other's sites using inside information gleaned from their employment against regular customers, even going so far as to provide guidance to their employees on how to avoid attracting unwanted attention when playing. In addition, Schneiderman alleges that DraftKings' data shows that almost 90 percent of its users lost more money than they won during 2013 and 2014, and that both Draft Kings and FanDuel used embedded gambling keywords to draw people searching for gambling to their sites.

In Nevada, the state's powerful Gaming Control Board issued a notice on Oct. 15, 2015, announcing that the state's attorney general's office had determined that daily fantasy sports is considered gambling under Nevada law, meaning that members of the industry must go through the state's licensing process.[4] In Massachusetts, Attorney General Maura Healy issued proposed regulations that would raise the minimum age for participants in daily fantasy sports to 21.[5] Adding further emphasis to this enforcement focus, there have been multiple reports that the U.S. Department of Justice and FBI have opened investigations into the fantasy sports industry.[6]

This newfound interest by attorneys general follows increased attention from high-profile media outlets, such as the New York Times and the Wall Street Journal, that have subjected the industry to heightened levels of scrutiny. For example, the New York Times recently reported that users located in states where daily fantasy is illegal were able to join leagues on DraftKings using readily available proxy servers that disguise the user's physical location.[7] Both sites have also been the subject of numerous class actions filed in various jurisdictions by customers alleging that the sites have engaged in unfair and deceptive business practices.

State Regulation of the Fantasy Sports Industry

States have passed robust and varied laws that govern the fantasy sports industry. Although each state defines illegal gambling on its own, in most states, a game is considered illegal gambling if it contains three elements: (1) consideration, (2) reward and (3) chance.[8] Most states use the "predominant purpose test" to determine whether a particular game is one of chance or skill.[9] Under this test, a game is considered a game of chance if chance predominates over skill in determining the outcome.[10] Other states, such as New York, apply a test called the "material element test." Under this test, a game is considered one of chance if chance has more than a merely incidental effect on the game.[11]

The Expansive Reach of Attorney Generals' Enforcement Authority

Separate and apart from their states' gaming laws, there are other avenues open to state attorneys general to pursue action against the fantasy sports industry. One example of this can be gleaned from

the regulations promulgated by Massachusetts Attorney General Healy. These proposed regulations demonstrate that it is possible for these regulations to substantively impact the fantasy sports industry apart from the state's gaming laws.

Another avenue open to state attorneys general is to conduct an investigation into whether a fantasy sports company's operations violate that state's consumer protection laws. Attorney General Schneiderman's action against DraftKings and FanDuel cite consumer protection concerns, in addition to New York's gaming laws. The numerous class actions filed against DraftKings and FanDuel, alleging that the companies engaged in unfair and deceptive business practices, underscore this risk. Attorneys general have particularly broad powers under the states' consumer protection statutes to pursue unfair and deceptive acts and practices, and they use these powers frequently.

A recent trend in this area is for attorneys general from several states to form a coalition to expand the investigation into potential violations of their states consumer protection laws. Joining these kind of coalitions — called multistate investigations — is increasingly popular among attorneys general for several reasons. First, and most significantly, multistate investigations allow the member attorneys general to pool their resources to handle large cases. Every attorney general has a very broad mandate, but limited resources to fulfill it. An investigation into even one large company, such as either DraftKings or FanDuel, could quickly overwhelm any single attorney general office's limited resources to investigate potential violations of the state's consumer protection laws.

A multistate investigation also brings greater bargaining power in settlement negotiations with a targeted company. The positive publicity from obtaining a substantial monetary settlement or forcing a company to alter or even cease operations is another factor considered by attorneys general — most of whom are publicly elected — in deciding whether to partner with other states in pursuing a high-profile investigation.

Preparing for and Minimizing the Risk of Attorney General Enforcement Activity

In light of the recent expanding scrutiny, as well as the likelihood of more activity in the wake of the impending New York lower state court decision, members of the fantasy sports industry should focus on minimizing the risk presented by other state attorneys general enforcement activity.[12] That said, the decision reached by Judge Mendez, though potentially setting initial precedent in New York, should be viewed by other states as having limited precedential value since it represents one judge's opinion from a lower state court and that opinion is based on the "material element test," a high standard not applicable in most states. Yet, even under that standard, the stay issued immediately by the appellate court calls into question whether Judge Mendez's interpretation will ever be the final say on the issue in New York.

Thus, industry members should consider the proactive establishment of relationships with the attorneys general offices in the states where they operate. This relationship, based on cooperation and transparency in an effort to work cooperatively with that state attorney general to establish a workable regulatory structure, which may include some mutually agreed upon alteration to the business model of the industry could help the industry avoid more draconian enforcement measures and sanctions.

A thorough review by industry members of their websites, online and print advertisements, and other marketing materials may also substantially reduce the risk of attorney general enforcement activity. Industry members should assess whether they can adequately substantiate and defend the validity of their claims about the way their leagues operate. Any such review should be performed with an eye

toward standards of general fairness and also applicable state consumer protection laws, with particular attention paid to whether consumers or attorneys general could view the language used as confusing, misleading or lacking transparency.

It is important for the industry member to establish an open and constructive dialogue with the attorneys general office or offices that are investigating. Engaging outside counsel with experience and a good relationship with the attorneys general can be a critical element in helping the industry member to establish a good working relationship and communicate its story effectively. Although expensive and protracted scorched-earth litigation may be necessary down the road, the best strategy for industry members may not be to immediately put on their battle gear. Counsel with a solid track record of working with state attorney general offices can potentially navigate a positive resolution short of litigation. This counsel will also provide useful insights into what to expect if an investigation progresses, and would be a valuable asset if litigation arises.

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[1] <http://www.ag.ny.gov/press-release/ag-schneiderman-issues-cease-and-desist-letters-fanduel-and-draftkings-demanding>

[2] See *People v. FanDuel Inc.*, N.Y. Sup. Ct., No. 453056/2015; *People v. DraftKings Inc.*, N.Y. Sup. Ct., No. 453054/2015. .

[3] See *DraftKings Inc. v. Schneiderman*, N.Y. Sup. Ct., No. No. 102014/2015; *FanDuel v. Schneiderman*, N.Y. Sup. Ct., No. 161691/2015.

[4] Nev. Gaming Control Bd., Notice No. 2015-99,
<http://gaming.nv.gov/modules/showdocument.aspx?documentid=10481>

[5] <http://www.mass.gov/ago/consumer-resources/consumer-information/dfs/>

[6] <http://www.wsj.com/articles/fbi-justice-department-investigating-daily-fantasy-sports-business-model-1444865627?cb=logged0.8123858859762549>

[7] http://www.nytimes.com/2015/11/14/sports/draftkings-leaves-door-ajar-for-barred-fantasy-sports-players.html?_r=1

[8] See I. Nelson Rose and Martin Owers, *Internet Gaming Law 1*, (Mary Ann Liebert, Inc., 2009).

[9] Marc Edelman, *A Short Treatise on Fantasy Sports and the Law: How America Regulates its New National Pastime*, 3 *Harvard Journal of Sports & Entertainment Law* 1, 29 (2012) (“A majority of states adopt ... the ‘predominant purpose test’ as the measure of chance[.]”).

[10] See, e.g., *Commonwealth v. Dent*, 992 A.2d 190, 193 (Pa. Super. Ct. 2010) (citing *Commonwealth v. Two Electronic Poker Games Machines*, 465 A.2d 973, 977 (Pa. 1983)).

[11] See *Pace-O-Matic, Inc. v. New York State Liquor Authority*, 898 N.Y.S.2d 295, 297, 72 A.D.3d 1144, 1146 (N.Y.A.D. 3 Dept. 2010) (citing New York's Penal Law § 225.00(1) and stating, "[Contest of chance] is defined as any contest, game, gaming scheme or gaming device in which the outcome depends in a material degree upon an element of chance, notwithstanding that skill of the contestants may also be a factor.").

[12] For the moment, the likelihood of federal legislative action in this area seems far off on the horizon.

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