

# Game Changer

Rethinking Online  
Gambling Regulation  
in the Age of Daily  
Fantasy Sports

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*By Steven Titch and  
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*May 2016*



ISSUE ANALYSIS 2016 NO. 2

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## Rethinking Online Gambling Regulation in the Age of Daily Fantasy Sports

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### Executive Summary

The rapid rise in the popularity of Daily Fantasy Sports (DFS), now a multi-billion dollar a year industry, represents a sea change in how Americans gamble and has rightly spurred a reevaluation of our gambling laws. The legality of non-sports online gambling was drawn out of its long-occupied gray area in 2011 by a Department of Justice opinion that paved the way for states to legalize and regulate certain forms of online gambling, as several have done. At the same time, it provoked opponents of expanded gambling to push for a federal prohibition of online wagering. The fragile legal status of online gambling in general, and of fantasy sports betting in particular, has resulted in responses from lawmakers, state gaming regulators, and state attorneys general that range from embracing legalization and regulation to calls for outright bans.

According to the Fantasy Sports Trade Association, more than 41 million people played fantasy sports in the United States and Canada in 2014. In recent years, much of the growth in fantasy sports revenue has come from daily fantasy sites, with Americans spending roughly \$3 billion on DFS each year.

The fantasy sports industry's two largest operators, FanDuel and DraftKings, assert that DFS is not gambling because it is a "game of skill," which puts it outside the purview of federal and state gambling statutes that regulate "games of chance." However, many state attorneys general disagree and are taking action to prevent such companies from operating outside of states' gambling laws.

At the same time, industry experts estimate that Americans spend upwards of \$145 billion a year gambling on traditional sporting events. Most of this

betting is illegal because of a federal law from the 1990s that disallows all but four states from regulating the activity. While these illegal wagers include innocent office pools and informal bets between friends, others are run by criminal syndicates and used to fund other illicit activities, including drug distribution and human trafficking.

The popularity of fantasy sports betting and the regulatory tangle developing around it demand a reassessment of gambling regulation in general, and online gambling regulation in particular. For years, online gambling sites simply recreated poker and established casino games like blackjack, roulette, craps, and slot machines, while offshore sites offered conventional sports betting. DFS, which has never been offered in a brick-and-mortar casino or sports book, owes its existence to the processing power and social networking scale the Internet provides. This, and the fact that the Internet creates virtual communities that can defy state lines and national borders, is forcing lawmakers to reevaluate the degree to which gambling can be regulated, how well prohibitions can be enforced, and whether the cost and resources needed to mount successful investigation and prosecution of illegal gamblers can yield any net gains in terms of community safety or health. Several states, including New Jersey and Pennsylvania, have taken steps to overturn the federal ban on sports gambling.

What kind of gambling regulations are best for America today? Why are online fantasy sports legal, while offline sports betting remains illegal? Should legal offline games, like poker or the lottery also be legal online? What would be the consequences of legalizing or criminalizing online gambling? Should regulation be left to the states or to the federal government? This

paper seeks to address these questions and provide a framework for regulating gambling in the age of DFS.

While the DFS industry will likely accept regulation in return for a stable operating environment, such regulation must be wisely implemented to be effective, allowing competition and diversity in game selection, and incorporating consumer protection against fraud and theft.

Good policy begins with recognizing that gambling, whether on the lottery, at the casino, or betting online on the big game, is a legitimate means of recreation. Rather than enforcing subjective morality or trying to protect people from themselves, modern gambling regulation should treat citizens as adults, restore individual choice, protect consumers from crime, and preserve the right of states to regulate and profit from gambling activities within their borders.

## Introduction

John Boveri did not think he was doing anything wrong until 11 police officers in full body armor busted into his condo in New Jersey, handcuffed him, and tore through his home. They told him they were looking for cash—more than \$800,000 he had collected from running a sports betting pool. The office pool, which started with just under 60 participants in 1999, had ballooned to more than 8,000 players by 2009. Boveri was charged with illegally promoting gambling and money laundering. He lost his job, his life savings, and may lose his freedom when his case finally goes to trial.<sup>1</sup>

As Boveri awaited his trial for more than five years, he watched as New Jersey attempted over and over again to make sports betting legal in his home state. At the same time, online contests like Daily Fantasy Sports (DFS), which offer cash prizes to players based on individual athletes' game statistics, became a multi-billion dollar industry virtually overnight. Ads for DFS run constantly on radio and television, and are splashed across city buses. Even professional sports leagues, which have long opposed offline sports betting, have sponsored or partnered with Daily Fantasy sites.

The controversy surrounding the widespread activity of fantasy sports betting is prompting federal and state lawmakers to ask what kind of gambling regulations are best for America today.

Why are online fantasy sports legal, while offline sports betting remains illegal? Should legal offline games, like poker or the lottery also be legal online? What would be the consequences of legalizing or criminalizing online gambling? Should regulation be left to the states or to the federal government? This paper seeks to address these questions and provide a framework for regulation in the age of DFS.

## State of Play

The rapid rise in popularity of Daily Fantasy Sports represents a sea change in how Americans gamble and has rightly spurred a reevaluation of America's gambling laws. The legality of non-sports related online gambling was drawn out of its long-occupied gray area in 2011 by a Department of Justice (DOJ) opinion that paved the way for states to legalize and regulate certain forms of online gambling, as several have done. At the same time, it spurred opponents of expanded gambling to push for a federal prohibition of online wagering. The fragile legal status of online gambling generally, and of fantasy sports betting particularly, has resulted in responses from lawmakers, gaming regulators, and state attorneys general that range from embracing legalization and regulation to calls for outright bans.

In Nevada, where almost all forms of wagering are legal and regulated, including online poker as of 2013, the

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state gaming commission ruled in October 2015 that DFS games constituted illegal gambling unless operators received a gaming license.<sup>2</sup>

In November 2015, Massachusetts Attorney General Maura Healey said DFS is legal gambling, but has proposed a series of regulations.<sup>3</sup>

In contrast, the same month New York Attorney General Eric Schneiderman declared DFS to be illegal gambling and ordered the shutdown of all DFS activity in the state.<sup>4</sup> Since then, attorneys general in Illinois, Texas, Hawaii, Mississippi, Georgia, and Vermont have issued advisory or non-binding opinions that DFS is illegal, but have made no further moves to stop DFS operations.<sup>5</sup>

Meanwhile, state legislatures have gotten busy. Kansas was the first state to legalize DFS in May 2015. Virginia followed in March 2016. As of late April 2016, bills to legalize or regulate DFS were pending in at least 32 states. In seven others, DFS legislation either failed or was withdrawn.<sup>6</sup> Matters are complicated by the tension created by several legal and regulatory factors that seem to operate at cross-purposes:

- The 2006 Unlawful Internet Gambling Enforcement Act (UIGEA), a federal Internet gambling law that prohibits processing of funds related to unlawful Internet gambling, but

excluded “fantasy or simulation sports game” from its definition of gambling (known as the “UIGEA carve-out”);

- The right of state governments to regulate gambling, commonly understood as belonging to the powers reserved to the states by the 10th Amendment of the U.S. Constitution;
- The 2011 Department of Justice memo that told states the Wire Act does not prohibit intrastate online gambling, as long as it remains within the state. In the same memo, however, the DOJ reiterated that the Wire Act still applies across the board to sports betting. Many argue that DFS is a form of sports betting.
- Current efforts in Congress to advance the Restoration of America’s Wire Act (RAWA), which would amend the 1961 Federal Wire Act to nationally prohibit most forms of online wagering;
- A record of legislative and judicial language that applies the definition of gambling largely to games of chance, not games of skill such as poker.

The fantasy sports industry’s two largest operators, FanDuel and DraftKings, assert that DFS is not gambling because it is a “game of skill,” which puts it outside the purview

of federal and state gambling statutes that regulate “games of chance.” In addition, they argue that if it were legally ruled by state authorities as gambling, the UIGEA carve-out would preempt state prohibition.

As noted, the major professional sports leagues, which historically have opposed any expansion of sports betting, not only tolerate DFS but have openly embraced it. In 2013, Major League Baseball (MLB) purchased an equity stake in DraftKings, a DFS competitor.<sup>7</sup> The following year, the National Basketball Association (NBA), purchased a \$250 million stake in FanDuel. The National Football League (NFL) has been quiet on the subject, although FanDuel<sup>8</sup> has multiyear sponsorship agreements with 15 NFL teams.<sup>9</sup> Jerry Jones and Robert Kraft, owners of the Dallas Cowboys and the New England Patriots, respectively, have invested in DraftKings, despite NFL policy that prohibits owners from holding equity in gambling enterprises.<sup>10</sup> NFL commissioner Roger Goodell has said the league is taking a “cautious approach” to any relationship with DFS.<sup>11</sup> While not attempting to stop individual teams’ involvement with DFS, Goodell expressed his belief that the 2006 law exempting fantasy sports betting from its online gambling rules “was aimed at season-long leagues and not daily leagues.”<sup>12</sup>

In April 2015, Disney Corp., owner of the ESPN sports network, was

reportedly planning to invest \$250 million in DraftKings, but has since backed out of the deal.<sup>13</sup>

According to the Fantasy Sports Trade Association, more than 41 million people played fantasy sports in the United States and Canada in 2014. In recent years, much of the growth in fantasy sports revenue has come from daily fantasy sites, with Americans spending roughly \$3 billion on DFS each year.<sup>14</sup>

The popularity of DFS and the legal and regulatory tangle developing around it call for a reassessment of gambling regulation in general, and online gambling regulation in particular. Until now, the Internet has simply recreated poker and established casino games like blackjack, roulette, craps, and slot machines. Offshore sites offer conventional sports betting. DFS, which has never been offered in a brick-and-mortar casino or sports book, owes its existence to the processing power and social networking scale the Internet provides. This, and the fact that the Internet creates virtual communities that can defy state lines and national borders, is forcing lawmakers to reevaluate the degree to which gambling can be regulated, how well prohibitions can be enforced, and whether the cost and resources needed to mount successful investigation and prosecution of illegal gamblers can yield any net gains in terms of community safety or health.

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## **Gambling Should Be Legal and Lightly Regulated by the States**

In the U.S., all but two states, Hawaii and Utah, have some form of legalized gambling. Most Americans gamble at some point in their lives, whether at a home poker game, a casino, or filling out an NCAA basketball tournament bracket. In a 1999 National Opinion Research Center survey, 68 percent of Americans reported having gambled at least once in the previous year, and 86 percent reported having gambled at least once in their lives.<sup>15</sup>

The popularity of gambling is not surprising, as it unites two defining human traits—the need to socialize and the need to compete. And there is evidence that we have engaged in some form of gambling since at least the dawn of recorded history. Gambling was depicted on the walls of Ancient Egyptian tombs. The casting of lots was part of Hebrew worship and used by Roman soldiers at the foot of the cross to divide Jesus's garments among them.<sup>16</sup> Almost every culture has developed its own gambling games. Ancient Persians played a racing game similar to backgammon. Romans bet on gladiatorial contests and chariot races. Early African tribes played "odds and evens." And the invention of the printing press helped make playing cards extremely popular in Europe.<sup>17</sup>

Despite this long history, recreational gambling has often carried a stigma, particularly in American culture. The

mathematics underlying successful gambling can be mystifying and counterintuitive to even well-educated people (see sidebar, What is Gambler's Fallacy?), leading many to feel games are rigged. To some religious traditionalists, gambling seems to nurture baser human tendencies like the desire to gain "something for nothing." A more practical economic view sees recreational gambling as a non-productive activity with little social value. Certain forms of risk—such as stock market investment, commodities trading, and insurance—have net social and economic benefits even if they sometimes lose money for investors. But gambling is zero-sum—there is no net material benefit to anyone but the winner, and there is always a loser.<sup>18</sup>

However, it is not the government's job to enforce morality, so some anti-gambling advocates cite "public health" concerns. For a very small percentage of the population, gambling is a compulsive activity, which gone untreated, can be destructive to the individual, his or her family, and community. Opponents of legalized gambling say the social costs of widespread gambling addiction outweigh any local employment, tax, or commercial benefits the gambling industry, brick and mortar or online, may generate.

On the other hand, gambling has entertainment value for those who

## Games of Skill versus Games of Chance

Most states determine the legality of gaming activities, in part on whether they are considered games of skill or games of chance, with the latter defined as gambling. For example, New York Attorney General Eric T. Schneiderman issued cease-and-desist letters to DFS operators, claiming they met the state's definition of gambling.<sup>i</sup> Operators like FanDuel retort that their games are skill-based, citing the fact that 50 percent of prize money on their site is won by just 1 percent of players.<sup>ii</sup> Similarly, federal statutes, such as the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) define the kinds of bets and wagers considered unlawful, based on whether or not games are "subject to chance."

To qualify as gambling in most jurisdictions, games need to meet the following criteria:

1. Players must risk something of value (consideration);
2. The risk is taken in order to gain something (reward); and
3. The outcome of the wager based on chance (chance).

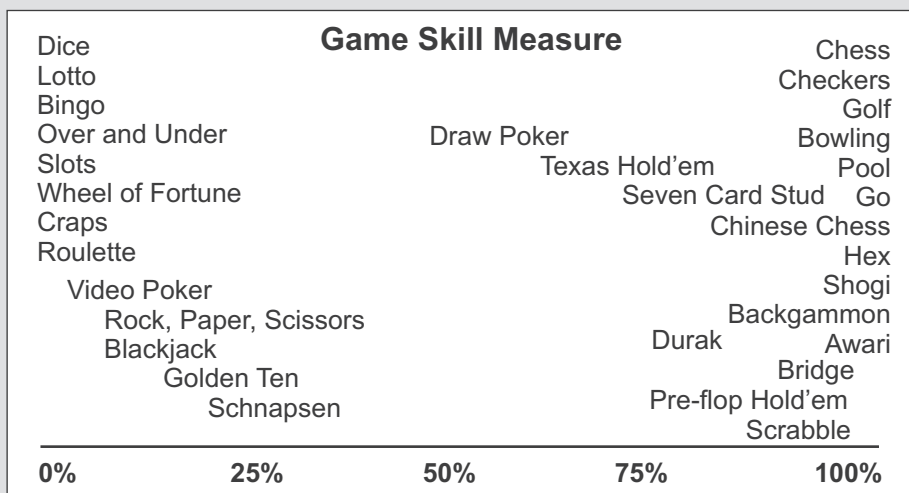
## The Dominant Principle Test/Element Theory

While activities like buying a lottery ticket or playing bingo are obviously based entirely on chance and activities like sporting contests are primarily skill-based, most games fall somewhere in the middle, with both elements of chance and skill. This is why courts are often asked to take up the question of whether or not a game is one of skill or of chance, with poker being the most frequent subject of such inquiries.

Courts determine if a game is dominated by skill or chance by relying on the Dominant Principle Test, according to which games qualify as skill games if:

1. Each participant in a contest has the distinct possibility of exercising skill and has sufficient data available to make informed judgements;
2. Players have the opportunity to exercise skill and have such skills (in varying degrees);
3. Players' skill and efforts sufficiently govern results; and
4. The standard of skill is known to players, and this standard governs the results.<sup>iii</sup>

Researchers have also created the *Game Skill Measure* (GSM), which gauges the amount of skill or chance in certain games and express it as a percentage which indicates the amount of control a player exhibits over the outcome of the game. Below is a chart of games as they fall on the spectrum from 0 percent (based entirely on luck) and 100 percent (based entirely on skill)<sup>iv</sup>



Source: Chuck Humphrey, "Poker as a Game of Skill: Recent Cases"

i Dustin Grouker, "New York AG to DraftKings, FanDuel: DFS is Illegal Gambling, Cease and Desist in NY," Legal Sports Report, November 10, 2015, <http://www.legalsportsreport.com/6075/new-york-says-dfs-is-illegal>.

ii Peter Harmon, "Analyzing FanDuel's Statistical Arguments on Skill versus Change at the New York Hearing," December 1, 2015, <http://www.legalsportsreport.com/6605/fanduels-skill-vs-chance-arguments/>.

iii Chuck Humphrey, "Poker as a Game of Skill: Recent Cases," American Bar Association, Spring 2009, <http://apps.americanbar.org/buslaw/committees/CL430000pub/newsletter/200905/humphrey.pdf>.

iv Roman V. Yampolskiy, "Game Skill Measure for Mixed Games," International Conference on computer, Electrical, and Systems Science, and Engineering, May 25, 2007, <http://cecs.louisville.edu/ry/Game.pdf>.



Game	Skill Factor	Luck factor	Beatable long term?	Required skills
Slot machines	None	High	No	Game selection, often aided by word-of-mouth. Higher denomination machines generally yield better return.
Video Poker	Medium	High	Yes, but often in combination with comps and cashback	Knowledge of playing strategy, game selection and understanding of pay tables, ability to leverage Players Club benefits.
Craps	Low	High	No	Game selection and optimal betting strategy, such as use of free odds, to minimize house advantage.
Roulette	None	High	No	None
Blackjack	Medium	Medium	Yes	Game selection; rote knowledge of basic strategy, card counting, and bet sizing; ability to avoid casino detection.
Poker	High	Low	Yes	Game selection; playing experience; understanding of pot odds, position, bet sizing, and opponent playing styles.
Sports Betting	Very High	Low	Yes	Thorough understanding of sports handicapping; ability to spot over- or undervalued situations or outright errors in odds-making; fingertip knowledge of daily up-to-date status of sports teams, lineups, players, schedules, and weather conditions; experience; bankroll management.
DFS	Very High	Medium	Yes	Currently evolving, but similar to sports betting; ability to spot over- or undervalued players; up-to-hour information on players and game conditions; understanding and correlating player statistics.
Lottery	None	High	No	None

engage in it. Additionally, playing skilled games like poker can encourage strategic and long-term thinking, and teach money and risk-management as well as interpersonal and math skills. For seniors, studies find those who engage in recreational gambling are generally healthier than their non-gambling counterparts.<sup>19</sup> Legal gambling businesses generate jobs and tax revenue, while giving gamblers who might have otherwise gambled illegally an option to gamble in legal venues that are not only safer, but where those with a gambling disorder may be identified and helped.

This tension between pro- and anti-gambling attitudes manifests itself in regulation. Although today in the United States 33 states allow casino gambling and 43 have lotteries, sometimes regulators attempt to “contain” gambling with paternalistic regulations that militate against the advantages legalization can bring. Sometimes state governments only permit casinos to be built in out-of-the-way places, such as on land that once supported heavy industrial operations, as if making casinos difficult to access will reduce their appeal. Instead, it only makes it more difficult for other businesses to develop nearby.

Moreover, when regulation is selective, permitting some games but not others, or creating regulations that paternalistically “protect” recreational gamblers from what regulators view as

bad habits or poor choices, it ends up harming rather than helping players, by leaving them with games that have worse odds or pushing them to gamble on black markets, where disorders and violence can flourish in the dark.

Ideally, all forms of gambling should be legal. Gambling regulation should be minimal, primarily aimed at safeguarding gamblers against fraud. As this paper shows, the expansion of gambling does not increase the incidence of gambling addiction.

### **Regulation Is a State Prerogative**

Regulation of gambling has been traditionally left to the states.<sup>20</sup> It should remain a state-level responsibility, without additional federal oversight beyond enforcement of existing federal laws that apply to all other businesses, such as tax responsibility, antitrust rules, and other economic regulations.

These same regulatory boundaries rightfully apply to online gambling. Despite claims that the Internet is inherently interstate, the experience of the three states and the many countries that have legalized online gambling demonstrates that the activity can be successfully fenced in through the use of technology.<sup>21</sup> The federal government has recognized the right of Nevada, New Jersey, and Delaware to legalize online gambling and is not interfering with legislation in other states that may

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consider doing the same. No matter how federal laws like UIGEA define “fantasy sports,” the federal government should not attempt to regulate online sports betting—which could lead to greater online gambling regulation overall.

In fact, doing so would create a huge regulatory problem, because it would place one type of gambling game under federal jurisdiction while others remained under state oversight. What would that mean should a brick-and-mortar casino want to offer DFS? Ordinarily, a casino gets permission to introduce a new game from its local gaming commission. In the case of DFS, would the casino have to seek permission from federal regulators?

Disputes between players and casinos fall under the authority of the appropriate state gaming commission. In Nevada, for example, the state gaming board has enforcement agents on duty 24/7, to handle problems.<sup>22</sup> Players who have called in complaints to the board say response time in Las Vegas is very fast, although it can take up to 90 minutes for an agent to reach casinos in outlying areas like Mesquite, 80 miles northeast of Las Vegas.<sup>23</sup> Federal regulation of DFS means the federal government would have to 1) create an entire infrastructure to manage enforcement, or 2) mandate this role to the state gaming agencies, perhaps without funding.

These are just a few of the headaches federal regulation of DFS could cause.

Another option is for Congress to prohibit DFS altogether. That would be bad policy for many reasons addressed later in this paper. Simply put, gambling regulation needs to remain where it has always been, at the state level, as properly delegated by the U.S. Constitution.

### **Benefits of Legalized Gambling**

In addition to recognizing the freedom of more citizens, legalized gambling, when implemented properly, comes with certain social and economic benefits.

Tunica County, Mississippi, provides a great example of how casino development can positively impact a community. The average unemployment rate for Tunica County decreased by 5.85 percent following the introduction of casinos. In 1991, prior to the introduction of casinos, the county’s unemployment rate was 16.2 percent. By 2000, after casino development brought in 14,000 new jobs, unemployment was 5.2 percent.<sup>24</sup>

### ***Greater Economic Development***

Prior to casino development, only about 33 percent of students graduated from high school in Tunica County. After casino development, that rate increased to 87 percent. There was a 29.6 percent decrease in residents’ need for food stamps. Temporary aid to families declined from 22.2 percent in 1991 to 6.6 percent in 1997. In 1991, only three walk-in clinics, all of which

closed at 7 p.m., served Tunica residents. Following the introduction of casinos, the town was able to support a 24-hour medical center with an on-site helicopter that could facilitate transfer to nearby Memphis of patients in need of more acute care.<sup>25</sup>

The experience of Tunica is not an isolated case. An earlier study that looked at Tunica and five other counties in Illinois, Iowa, Mississippi, and Missouri found a general economic improvement in the years following gambling legalization. Employment gains tended to be greater in rural counties that adopted casino gaming as a major or predominant industry. The authors conceded the impact of casino gaming on employment in metropolitan counties was harder to discern, because casino gaming constitutes a small portion of total employment. However, their research showed that casino gaming in urban areas can still constitute a moderate portion of net payroll employment gains or losses, even though it is a minor industry.<sup>26</sup>

### ***Increased Tax Revenues***

Legalized gambling provides states with an additional revenue stream. When gambling is prohibited, gamblers will either drive to legal casinos across state lines or gamble illegally, either in underground operations or online.

The Internal Revenue Service (IRS) recognizes professional gambling as a

legitimate occupation, and casinos, both brick-and-mortar and online, must report significant gambling winnings to the IRS via Form W2G.<sup>27</sup>

Online gambling provides an opportunity to maintain this revenue, given that Internet-based platforms are more popular among younger Americans, especially millennials, who constitute the largest group of visitors to gaming sites, but generally spend less money on casino floors.<sup>28</sup> The casino industry itself is looking to increase gaming revenue, which has significantly declined since the mid-1980s.<sup>29</sup> Clearly, the industry covets the market DFS has tapped, and is trying to increase consumer interest through the introduction of skill-based variants on the video games today's young adults, who are now in their 20s, grew up with, arcade games like Pac-Man and first-person shooters, which raises the skill-vs.-chance regulatory question (see sidebar, Games of Skill versus Games of Chance).<sup>30</sup>

This should interest state lawmakers, because revenues from casino taxes are flat. A September 2015 Pew study found that casino tax revenue in 16 states increased just 0.1 percent in 2015 compared to the year before, adjusted for inflation. And that number was buoyed by Maryland, which benefited from the opening of a new casino in Baltimore. Remove the Old Line State, and casino tax revenue actually declined 1.2 percent in the

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other 15 states.<sup>31</sup> Online gambling, including poker and DFS, offers an opportunity to capture taxes from these otherwise untaxed streams, without raising taxes on casinos, which are already taxed more than other businesses—and which pass these taxes along to consumers, in the form of lower payback percentages and fewer complimentary extras such as drinks, meals, and merchandise.

#### ***Reduction of Illegal Activity***

Opponents of legal online gambling argue that it will lead to increased criminal activity, but the European experience with online poker shows otherwise. Countries with legal online gambling demonstrate that with a sound legal, tax, and regulatory framework, decriminalization of online gambling fosters an honest, compliant online gambling ecosystem that draws users away from illegal operators.<sup>32</sup>

While the federal government once had its hands full investigating organized illegal gambling in the 1950s and 1960s, today it focuses on stateside operations that transfer money to legal gambling sites offshore. This is one of the complications engendered by UIGEA. The 2006 law does not prohibit the gambling activities themselves. Instead, it bars wire transfers related to “unlawful Internet gambling” businesses. While it lists some activities, like fantasy sports betting, it considers lawful (or at least not covered by the law), it does not specify

the types of Internet gambling it deems *unlawful*. Some form of Internet gambling is legal in at least 85 other countries. For gambling websites based outside of the U.S., the law was practically unenforceable.<sup>33</sup>

Illegal betting, particularly sports betting, remains rampant in the U.S. And despite UIGEA and the resources the government at all levels expends to enforce it, offshore sites get tens of millions of visits from U.S.-based users and handle millions of dollars in wagering action.<sup>34</sup>

Although enforcement efforts have led to arrests and prosecutions, they hardly dent illegal activity in the long run, leading the authors of a 2015 *New York Times* investigative series to ask: “[I]s the better way—with gambling increasingly woven into the fabric of American sports—to simply legalize it so it can be regulated?”<sup>35</sup> The answer is, yes. Legalizing gambling takes it out of the shadows. Players are better protected because games can be inspected, cheating accusations and payout complaints can be investigated, and disputes can be lawfully resolved.

#### **Social Issues Associated With Gambling**

##### ***Gambling Disorders***

In addition to gambling, other normal human activities—such as eating, sex, use of the Internet, and video games—have been accused of fostering “addiction,” often without meeting the



clinical definition.<sup>36</sup> Many who have experience with substance addiction feel labeling behavioral abnormalities as “addictions” devalues the seriousness of the pathology. Others believe the “addiction” label, when too broadly applied, becomes an easy excuse to evade embarrassment or responsibility for the consequences of deliberate choices.

Current research finds that behavioral addictions exist, but are rooted in the same physiological and neurological conditions as chemical addictions like drugs and alcohol. Compulsive gambling is just one way a preexisting general addiction disorder can manifest itself.<sup>37</sup>

Gambling addiction, more properly identified as gambling disorder, is a problem that affects only a small portion of the population and is not so widespread as to justify paternalistic population-wide prohibition. For example, despite the fact that the National Institute on Alcohol Abuse and Alcoholism puts the prevalence of Alcohol Use Disorders at about 7 percent of the adult American population, almost no one suggests we should ban alcohol for *all* adults.<sup>38</sup> According to most research, only about 0.5 to 2 percent of the worldwide population has a form of gambling disorder, defined as the compulsive need to gamble regardless of the consequences. Persons with gambling

disorders will tend to compulsively binge gamble, risking funds they cannot afford to lose.<sup>39</sup> In the worst cases, absent an intervention, individuals with a gambling disorder will continue to gamble until they no longer have the financial means to do so.

Gambling opponents often claim that anywhere from 1 to 15 percent of the population is at risk of gambling addiction.<sup>40</sup> But to arrive at these numbers, they often mix genuine cases of gambling disorder with instances of poor emotional or impulse control—the hypothetical individual who, visiting Las Vegas for the first time, “goes on a tilt” and loses much more money than intended. This person goes home, spends the next month living on a tight budget, and may never gamble again. But some advocates would classify him as a “problem gambler” who would be put at risk by legalization.

Addiction experts, such as Dr. Howard Shaffer at Harvard University, say numbers routinely quoted about gambling disorders are too high. According to his research, about 3 to 3.5 percent of the population have problems controlling themselves when gambling, but fall short of qualifying for the diagnostic criteria of a disorder.<sup>41</sup>

More significantly for lawmakers, studies show that prohibition does not affect the rate of gambling disorders. For example, the percentage of the population with gambling disorders in

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Utah and Hawaii, where all gambling is illegal, is consistent with the rate in states where legal gambling opportunities are widely available. Neither was there a surge in gambling disorders when online gambling began in the 1990s.<sup>42</sup> If, as prohibitionists claim, there is a linear relationship between exposure to gambling and gambling problems, the prevalence of problems in Nevada should be at least eight times more than any other state. Yet, Nevada ranks among states with the lowest incidence of gambling disorders. A study published in the *American Journal of Orthopsychiatry* estimates that only 0.3 percent of Nevada's adult population had clinical-level problems during 2006, the year the research was done, whereas national estimates for clinical-level gambling disorders are closer to 1 percent.<sup>43</sup>

In contrast to conventional wisdom that more gambling means more addiction, there is evidence that gambling disorders decrease in an environment where there is a high availability of gambling, much in the way new studies show infants and toddlers develop better immune systems when exposed to germs and allergens at an early age. Shaffer and his colleagues call this "adaptation." As noted, the prevalence of problem gambling is lower than the national average in Nevada. Moreover, the same research shows that the Nevada residents most

prone to gambling disorders are those who have moved to the state within the previous three to four years. Among residents who have lived in the state longer than four years, the incidence of gambling disorders is far lower. Shaffer suggests this adaptation factor should be considered when debating whether gambling legalization creates long-term social problems.<sup>44</sup>

While one might counter that the decrease is attributable to people with gambling disorders who leave Nevada as a response to their problem, this pattern of adaptation is observable in other states where gambling is legal. A study in Iowa that looked at metrics prior to the introduction of gambling in that state, concluded:

Despite these limitations, the current findings are consistent with Shaffer's adaptation hypothesis of 2005. They suggest that rates of [problem gambling] may be lower in Iowa now than in the past, despite expanded gambling venues in the state.<sup>45</sup>

Contemporary research places gambling disorders on a spectrum ranging from mild to severe.<sup>46</sup> The opportunity to gamble does not create the disorder. In most cases, some aspect of the addiction disorder is already present, waiting to be triggered by any number of activities that will satisfy the dysfunction. This could be shopping,

eating, sex, or other potentially addictive behaviors.<sup>47</sup> In most cases, a substance use disorder precedes problem gambling.<sup>48</sup> Gambling bans are unlikely to address these problems. Those with gambling disorders, driven by compulsion, will seek out illegal gambling, or see their underlying compulsive disorders manifest themselves in other ways.

On the other hand, regulation of legal gambling operations can help address gambling disorders. For example, licensed online casinos in Delaware, New Jersey, and Nevada are required by law to recognize “self-exclusion lists,” which enable consumers to voluntarily block their own access to gambling sites. Harvard researchers found that players who signed up for lifetime exclusion bans had significantly reduced gambling-related problems.<sup>49</sup> Online casinos can also use behavioral tracking tools, such as PlayScan and Observer, which utilize a combination of behavioral science, psychology, mathematics, and artificial intelligence to compare players’ behavior against known patterns of problem gamblers. They can spot when a player is displaying signs of problem gambling and alert the operator or advise the player to seek help.<sup>50</sup>

### ***Less Underage Gambling***

Opponents of online gambling often make the case that minors will be able to sneak onto gaming sites, which will then ensnare them. Research tempers

this fear, however. Nevada, the state with the most casino gambling, is among the states with the lowest rate of youth gambling disorders.<sup>51</sup>

While brick-and-mortar casinos can ask for ID of teens who might be able to pass for adults over 21, ID checks are not infallible. U.S. casinos are regularly fined for letting minors gamble and drink on their floor.<sup>52</sup> While Internet sites cannot visually spot an underage player, they can cross-reference a player’s registration data with publicly available information on the Web to check for discrepancies in age, and require information such as Social Security numbers. But as with physical casinos, such checks are not foolproof.

However, the biggest obstacle to underage online gambling is access to funds, which requires a credit or debit card. A motivated teen could get a hold of a parent’s credit card, negotiate an electronic application form, and successfully make a deposit. Yet, even if the occasional precocious kid gets this far, he could be tripped up immediately if he deposits too much or makes too many successive transactions. At that point, the credit card company, alerted to a possible stolen card, calls the cardholder to verify the transactions. Finally, even if a parent is not alerted at the time of the transaction, he or she will notice it once the bill arrives.<sup>53</sup>

There is a tone of moral panic in the way some opponents of online gambling,

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### ***What is Gambler's Fallacy?***

"The dice are hot!"

"That dealer's cold!"

"That machine's due to hit any minute!"

Spend a short time in a casino and you are likely to overhear something akin to this. Do not give it too much credence.

Gambler's Fallacy is the erroneous belief that the probability of a specific outcome of a random, independent trial can change based on the series of previous outcomes of that same independent trial.

It is a common error, arising from conflating of the probability of an outcome single trial with the probability of the same outcome several times in a row.

The best example is a coin flip. Assuming an unbiased toss, the probability of the coin coming heads is 50 percent. That 50 percent probability remains the case each time the coin is flipped.

Confusion arises from the fact that the probability of flipping heads twice in a row is 50 percent squared, or 25 percent (one in four). The probability of heads three times in a row is 12.5 percent (one in eight). The fallacy occurs when the gambler assumes that after a coin has landed heads twice in a row, there is only a 12.5 percent chance of it landing heads again on the next toss. The gambler has forgotten that each toss is an independent event. The previous outcomes have no bearing on the upcoming toss. The actual 12.5 percent calculation concerns the outcome of one trial consisting of three successive tosses. The expectation is that in a trial of three coin tosses, one out of eight times will result in three heads in a row and seven out of eight times will not.

No matter what a gambler may say or believe, "hot streaks" in dice or cards cannot be identified while they are occurring. They are only apparent after the fact, when we can look back and see the effects of variation over time.

such as brick-and-mortar casino magnate Sheldon Adelson, try to link the dangers of online gambling with general concerns about the Internet use by children and teens.<sup>54</sup> They seem to suggest that a child's experiment with online poker will give him or her a taste for the action and eventually turn him into a compulsive gambler. However, there is little evidence that Internet gambling sites have roped in unsuspecting children. Recent studies have found that online gambling is no more addictive than traditional forms of wagering.<sup>55</sup> The truth is that kids have always engaged in wagering games—from marbles to flipping baseball cards to pitching pennies. For most kids, they can be memorable introduction to the limits of both skill and luck that never leads to disordered gambling behavior.

### ***Morality, Economics, and Crime***

Many people believe gambling is wrong in and of itself. While that belief may be sincere, it is a shaky foundation on which to legislate prohibition, even in states where anti-gambling sentiment might prevail.

When not invoking "for the children" or addiction arguments, prohibitionists buttress their moral posturing with the contention that gambling money amounts to unproductive spending, turning to respected economists such as Paul Samuelson who declared that gambling involves "simply *sterile transfers of*

money between individuals, creating no new value. While creating no value, gambling does nevertheless absorb time and resources. ... [I]t tends to promote *inequality* and *instability of incomes*.”<sup>56</sup> [Emphasis in original]

But just as valid is the idea that an individual has the right to use her money in pursuit of her own satisfaction. The principle that a society benefits as a whole when individuals can freely conduct transactions that exchange value for value undergirds a free market and a free society.

The assertion that money lost in recreational gambling contributes no net gain to society is highly subjective. First, there is the obvious material return for the winner. The loser may have gotten a measure of enjoyment from the thrill of the wager itself, added entertainment from the sports event that was wagered on, or the game in which he participated.

The material aspect is also arguable. That professional gamblers exist with skill-based games like poker, blackjack, and sports betting, means it is possible to make a living from the activity.

While not as glamorous or easy as depicted in movies, some people have an undisputable skill for it. Poker, for example, requires a talent for quick calculation of mathematical probabilities, an ability to read people, and the sustainable concentration to detect and exploit patterns and habits

from many different opponents over the course of several hours or days. Sports handicapping requires the analytical skills of an insurance actuarial or financial analyst.

The successful gambler, like an investor, hedge fund manager, or insurance provider, must monetize risk. The difference is that stocks, bonds, and insurance have positive expectations over the long-term, while most gambling games do not (see sidebar: What is EV?). Yet, professional gamblers are skilled enough to overcome the inherent negative expectation—impossible in most games and difficult even in skill-based games like poker, blackjack, sports betting, and video poker, where the “house” advantage is lower or nonexistent. There is nothing zero-sum about income from successful gamblers, whose winnings find their way into the economy. Gamblers shop at the supermarket, own property, and pay taxes.

In the United States, we do not legislate utilitarian economic policy based on the perceived relative value of economic activities. For example, season tickets for professional sports teams can cost thousands of dollars. While some of that money trickles down to team employees and part-time stadium workers, most of it goes to already wealthy team owners and athletes who are paid millions of dollars to play, in the words of critics, “kids’ games.”

Yet, we generally do not criticize the

*There is nothing zero-sum about income from successful gamblers, whose winnings find their way into the economy. Gamblers shop at the supermarket, own property, and pay taxes.*



*Prohibiting  
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laundering.*

avid sports fan who purchases a season pass. Similarly, we do not prevent a consumer from purchasing a \$600,000 hand-built, high-performance foreign sports car, though arguably that money would have more social utility if used to purchase a couple of dozen \$30,000 automobiles from a domestic manufacturer.

Gambling opponents also claim that casinos, live or online, attract crime and can be used for money laundering, a vital component to criminal enterprises from drugs to terrorism. But singling out gambling as a culprit is, once again, disingenuous. Research shows that any location where large numbers of people with sizable amounts of cash or valuables gather will attract criminals.

Studies of activity around stadiums in the UK and U.S. during sporting events have shown a possible connection between sports facilities and crime in the areas around them. “Any business that you’d call a destination hotspot that draws people who are potential victims can attract crime,” according to Richard McCleary, a professor at the University of California, Irvine’s School of Social Ecology.<sup>57</sup> Everything from theme parks to concert venues and large outdoor festivals are targets for muggers, thieves, pickpockets and troublemakers.<sup>58</sup>

As for money laundering, land-based casinos in the U.S. must comply with cash reporting laws and participate in

the Treasury Department’s Financial Crimes Enforcement Network (FinCEN). As with brick-and-mortar casinos, online gambling sites are considered financial institutions and are required to comply with the same federal statutes.

Gambling venues are just one of many legitimate enterprises that can be exploited for money laundering. Any business that handles large amounts of cash is susceptible, which is why the USA PATRIOT Act and the Bank Secrecy Act require financial institutions to collect Social Security numbers and file currency transaction reports for transaction of \$10,000 and above.<sup>59</sup>

Independent studies have shown that in recent years, casinos have come to excel at compliance. A January 2016 report from Ernst & Young found that casino operators have implemented “a sweeping series” of customer due diligence procedures that monitor illicit behavior. “Most regulators and officials we spoke with noted that casinos have improved the overall quality of regulatory filings pertaining to (anti-money laundering) and continue to aid law enforcement investigation efforts,” said Ernst & Young partner Tom Roche, head of the firm’s Global Gaming Services and a former Nevada Gaming Control Board member.<sup>60</sup>

Prohibiting online gambling will not prevent money laundering. As long as there ways to anonymously transfer

funds, whether in cash or easily convertible items like jewelry or precious metals, money laundering will remain a problem. And laundering funds in overseas markets that may have little oversight is far more appealing than a highly regulated and documented U.S. market.

### ***Cheating***

A common objection to online gambling is that it harbors cheating and dishonesty. Indeed, there have been online gambling cheating scandals, but most gaming sites are owned by publicly traded companies and operate honestly. Site reputations are easy to check with a simple Internet search. And many third-party sites targeted at poker players and other recreational gamblers, such as eCogra, rate sites and sometimes provide a certificate based on the quality of games, speed of payout, customer service, and dispute arbitration.<sup>61</sup>

The biggest problem online poker sites face are “bots,” software programs that automatically play tables as close to perfect as possible.<sup>62</sup> Since bots drive away players, site operators dislike them as much as players do. Fortunately, there are software countermeasures sites can take to identify and block poker bots. There is also a growing amount of information online players can use to spot a bot and learn how to play against one.

As noted, thieves, cheats, and fraudsters will be attracted to anywhere there are

large amounts of money. There is no reason to believe the risk to players online is any greater than at brick-and-mortar casinos, which have had their own share of problems. For example, in January 2014, a tournament player in Atlantic City introduced counterfeit chips into a poker tournament. He was caught and convicted.<sup>63</sup> In 2013, cheaters gained remote access to the surveillance system for the Crown Casino in Melbourne, Australia, and used the images to cheat players out of more \$32 million AUD.<sup>64</sup> (U.S. \$24.53 million)

Many concerns about cheating that arose when online poker first appeared in the 1990s have since been addressed.

Poker is a much more difficult game than it appears, especially online.

Perhaps it is human nature for smart people, when they lose at what they perceive as an easy game, to believe a game is rigged. This attitude can affect some of the best players in the world.

At the 2015 World Series of Poker (WSOP) \$10,000 heads-up event (where participants play against only one other person at a time), several top poker pros, after being defeated by Valeriu Coca—until then a relatively low-stakes player—accused Coca of marking the cards. An investigation by the Nevada Gaming Control Board cleared Coca, who said: “The players who lost are very good, so they just don’t believe they could lose to me for an honest reason.”<sup>65</sup>

*The Professional and Amateur Sports Protection Act is something of an odd duck—it permits states to legalize sports betting, but enjoins them from regulating it.*

*It is just too difficult for one or two players to affect the outcome of a game.*

### ***Sports Betting and Game Integrity***

In its 2015 series on illegal gambling, *The New York Times* raised the issue of how sports betting might affect the integrity of sports. This is the principal concern of sports leagues like the NFL regarding legal sports wagering. As noted, sports betting is the only area of betting that comes under federal jurisdiction. The Wire Act prohibits interstate telecommunications transmission of sports gambling activity, and the 1992 Professional and Amateur Sports Protection Act (PASPA) limits sports betting to the four states where it was already legal or made legal within a year of the law's enactment: Nevada, Delaware, Oregon, and Montana. Still, PASPA is something of an odd duck—it permits states to legalize sports betting, but enjoins them from regulating it. New Jersey, in an attempt to introduce sports betting, challenged the law in 2012 and 2013. In both cases PASPA was upheld by a lower court and then by the Third Circuit Court of Appeals.<sup>66</sup> Furthermore, New Jersey is being sued by the NCAA, the NFL, and other sports leagues for a 2014 law that repealed the state's sports betting ban, presumably allowing unregulated sports betting to take place in the state. The Third Circuit held an en banc rehearing of the case in February 2016 and a ruling is expected in the summer.<sup>67</sup> Court decisions like this could be significant for fantasy sports contests should they be ruled a

form of sports betting.

Still, despite billions wagered on sports, both legally and illegally, game fixing is rare and hard to accomplish effectively. The most infamous sports fixing scandal, the conspiracy to suborn eight members of the heavily favored Chicago White Sox to throw the 1919 World Series to the Cincinnati Reds, was hard to keep secret, even in the days when telegraph was the primary means of long-distance communication. As author Eliot Asinof notes in *Eight Men Out*, gamblers and sportswriters were well aware of the rumors of the fix well before the first pitch was thrown.<sup>68</sup> Gambling was rampant in baseball in the early 20th century, and the nefarious influence of the “Black Sox Scandal” continues to resonate in professional leagues' current fears about sports betting nearly 100 years later.

Professional sports are no longer played under the conditions of 1919. The biggest change was the end of the “reserve clause,” which prohibited players from changing teams without the owners' permission. Today, professional players have the leverage to command salaries based on their worth. In an era when players were routinely and grossly underpaid, Charles Comiskey, owner of the White Sox, was especially notorious for his parsimony. Historians agree that the antipathy Comiskey engendered among the team contributed to their willingness to take money to throw the World Series.<sup>69</sup>

Game fixing is also difficult to pull off. A plan to bribe players on the Boston College basketball team during the 1978-1979 season failed badly, costing fixers tens of thousands of dollars. It is just too difficult for one or two players to affect the outcome of a game.<sup>70</sup>

As a further deterrent, gambling remains the one unpardonable sin for players among sports leagues. The eight White Sox players accused of the World Series fixing were acquitted in court, but were banned from professional baseball for life.<sup>71</sup> In more recent years, Pete Rose, who holds the all-time record for most hits, has been exiled from Major League Baseball since 1989, when considerable evidence surfaced that he gambled on games.<sup>72</sup>

Furthermore, it is hard to argue that *legalizing* sports gambling will somehow lead to match-fixing when the billions of dollars Americans wager *illegally* have not already done so. In fact, Americans spend upwards of \$380 billion a year on illegal sports betting.<sup>73</sup> If referees, coaches, and players could legally gamble on sports, they would not be any more motivated to throw or call games for financial gain. In fact, because of the oversight and record-keeping that comes with regulated gambling, leagues would be more likely to spot connections between gambling and match-fixing if sports betting were legal.

Notably, some professional sports leagues are wavering in their opposition to sports betting. NBA Commissioner Adam Silver has since called for repeal of PASPA, even though the NBA joined the lawsuit to stop New Jersey from legalizing sports betting.<sup>74</sup> Major League Baseball remains lukewarm on the expansion of sports betting, but its commissioner, Rob Manfred, has doubled down on DFS, telling ESPN that he “has no regrets” about MLB’s partnership with DraftKings.<sup>75</sup>

NFL Commissioner Roger Goodell remains steadfastly opposed to the expansion of sports betting, and parses his words carefully on DFS, saying it is up to the government to decide whether it constituted gambling.<sup>76</sup> The NFL does not hold equity stakes in any DFS company, although it tacitly endorses DFS in allowing team owners to hold stakes, and its cable channel, NFL Network, airs programming aimed at fantasy players.

### **Effective Gambling Regulation**

As noted, gambling is completely prohibited in just two states, Utah and Hawaii, while in the rest of the country ambivalent attitudes toward gambling seem to prevail. Many states that prohibit casino gambling host lotteries and allow pari-mutuel horse racing. With the decline in popularity of horse racing, some states have allowed race

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*The authority to oversee gambling regulation historically has been understood as among the unenumerated rights reserved to the states by the 10th Amendment to the U.S. Constitution.*

tracks to install slot machines and video lottery terminals, giving birth the term “racino.”

***Permit a Variety of Games with Better Odds***

Legislation prohibiting online gambling or Daily Fantasy Sports makes no sense in states that allow lotteries, race track betting, slot machines, or casinos.

States that liberalize gambling create better options for both casual and serious players. Those that limit legal gambling to certain types of gambling games or machines may believe they are acting in consumers’ interests, but they actually leave consumers with costlier, less engaging choices and players may be misled into believing they are playing a game with better odds than they actually are. A better deal would be to allow casinos to have more control over which games they can offer.<sup>77</sup>

Lotteries, the most common form of state-sanctioned gambling, which return between 40 to 60 cents on the dollar, are one of the worst bets anyone can make. Even when payoffs climb to stratospheric heights, as when the biweekly Mega Millions multi-state game’s jackpot reached \$648 million in December 2013, the \$1 ticket has considerable negative expected value when the number of purchasers, the likelihood of multiple winners, taxes, and lump-sum payout penalty are calculated into the equation.<sup>78</sup> The

odds of winning this Mega Millions jackpot were around 1 in 259 million. Compare that to the odds of being struck by lightning within your lifetime (1 in 3,000), killed by a shark (1 in 3.7 million), or struck by a comet (1 in 250,000).<sup>79</sup>

***Regulation Should be Overseen by States, not the Federal Government***

The authority to oversee gambling regulation historically has been understood as among the unenumerated rights reserved to the states by the 10th Amendment to the U.S. Constitution. While the federal government has played a role in enforcement of gambling laws in the form of the Wire Act, which polices interstate gambling transactions via telecommunications networks, and PASPA, which prevents states from “sanctioning” sports betting, to date there is no federal law that regulates or outlaws gambling. Congress should continue to respect this Constitutional barrier.

***Protect Consumers from Fraud, Theft, and Abuse***

The primary purpose of state gambling regulation should be to protect consumers from fraud, theft, and abuse. State regulators may ensure games are fair, finances are transparent, and gaming equipment—cards, dice, roulette wheels in brick and mortar casinos, or software used by online sites—is subject to testing and



inspection. Consumers should have a means for resolving claims and disputes. A good model is Nevada's Gaming Commission, which keeps agents on call (on-site in some larger casinos) 24 hours a day, seven days a week to handle disputes.

In addition, state laws generally require brick-and-mortar casinos to have their gambling floor under widespread video surveillance. Under Nevada law, all recordings must be retained at least two weeks (digital storage permits casinos to archive recordings much longer, which many do). Similarly, online operators already archive all play. Every online poker hand has a unique reference number accessible by players. Legal parameters can be created for retention of this to ensure preservation of any audit trail.

### ***Provide Safeguards for Minors***

States already set age limits for access to brick and mortar and online casinos, and make casinos responsible for compliance under threat of penalty or fine. The same is true for online casinos, which already perform age verification based on personal information. States may require online sites to compare age and identity information a user

enters with information freely available online, and prior to granting access, offer up a series of verification questions much like banks do before allowing a money transfer. Sites like PokerStars and OnlineCasinos.co.uk remind parents not to save passwords, to close out of gambling apps when finished, and to use software to monitor their children's computer usage. States can require sites to carry these guidelines, as well as promulgate them through their own communications channels. As discussed, while a child or teen may be able to access a gambling site, it is difficult for him or her to play without access to a credit card or bank account.

### ***Do Not Distinguish between Games of Chance and Skill***

Many states determine legality of games based on whether they are considered games of skill or games of chance. While games dominated by chance, such as a slot machines, are considered gambling (and may or may not be legal), games in which players can influence the outcome—like poker or pool—are considered games of skill and treated differently than pure gambling.

## **DFS Skills**

Professional gamblers studying DFS have said the game is still so new that operators are having trouble setting correct daily values for player salaries. A key skill needed for DFS is the ability to maximize the value of the salary cap—the budget DFS players have to spend on “salaries” of the athletes they draft. This prevents players from loading up their lineups with superstars at every position. The strategy is to balance superstars with second- and third-tier players who are likely to have a good statistical day.

A key skill, then, is to identify players whose salaries for the day are undervalued in relation to the probability of a strong performance, and avoid high-salaried players who might be in for a bad day. In addition, reputable gambling writers, such as poker expert Ed Miller, say the DFS sites often fail to adjust athlete salaries optimally to match supply-and-demand trends in the playing pool.<sup>1</sup> Similar situations arise from time to time in sports handicapping, and can be a boon to observant sports bettors who can deduce when a point spread or over/under proposition is incorrectly set. It is just as much an advantage in DFS wagering.

Chris Grove, “Ed Miller: Daily Fantasy Sports Model ‘Totally Broken’ In Status Quo,” Legal Sports Report, Dec. 21, 2014, <http://www.legalsportsreport.com/159/structural-issues-with-daily-fantasy-sports/>.

*Legal income  
is legal income,  
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making judgments  
about its source.*

States should revise legal definitions of gambling to end the distinction between chance and skill. This artificial and ill-defined distinction creates regulatory headaches in states like New York and Texas, where DFS, as a game of skill, does not meet the legal definition of gambling. However, should that argument carry the day, it immediately raises the question as to the prohibitions against other games that could arguably be considered games of skill, such as blackjack, video poker, and sports betting, where the outcome is influenced by the skill of player decisions (see table page 8).

In 2012, a Federal District Court in Brooklyn ruled poker is a game of skill and therefore not illegal under New York State's Illegal Gambling Business Act.<sup>80</sup> This ruling was later set aside by the Second Circuit Court of Appeals.<sup>81</sup> But even the appellate court's decision relied more on interpreting the language of gambling law than refuting the argument that poker is a game of skill.<sup>82</sup> This might only mean more problems for DFS legislation and regulation down the road.

A better approach would be to revisit the skill vs. luck question and accept that any wagering can incorporate one, the other, or both. It would make legal decisions easier and regulatory processes smoother.

### ***Make Taxation Fair***

Online casinos—and casinos in general—should be treated like any other business, and not be subject to discriminatory taxation.<sup>83</sup> While just about every other business is taxed on net income, casinos are taxed on their gross gaming revenues. States should avoid creating new tax structures purely on the idea that gambling is a vice or sin. Players should not be taxed through levies on their accounts or through “hand charges” that are paid directly to the state, as some European countries have attempted—without success, as players migrated to Internet casinos based in countries without such taxes.

Instead, states that do not allow deductions for gambling losses and related expenses should align their rules with the IRS, which recognizes gambling as an occupation and allows qualified filers to deduct losses and expenses. Again, the spirit behind laws that tax winnings but disallow losses reflects the subjective moralism that gambling winnings are somehow “ill-gotten.” Legal income is legal income, and the state should not be making judgments about its source.

### ***Regulations Should Maximize Competition***

In their ambivalence about gambling, lawmakers often compromise by legalizing gambling, but restricting

the number of licenses available. In other industries, from taxis to telecommunications, government attempts to limit market entry result in higher prices for consumers and unhealthy cronyism between government and favored interests.

Whether online or live, the industry should be allowed to meet consumer demand. Each enterprise should be able to succeed or fail based on its ability to serve its customers' needs. When government gets involved either by restricting entry, as in Illinois, or granting tax breaks and benefits, as in New Jersey, problems arise. In Illinois, for example, the battle for the state's limited gaming licenses has been rife with corruption and the state has a history of governors attempting to manipulate the gaming board for unethical purposes.<sup>84</sup> On the flipside, New Jersey's policies encouraged casino overdevelopment in Atlantic City, concentrating a large number of resorts in an area of the state that had little more to offer than the beach and boardwalk, but was not a year-round holiday destination.<sup>85</sup> These factors were overlooked as long as New Jersey held a regional monopoly on casino gambling, but once Connecticut, Pennsylvania, and Maryland legalized casinos, the disadvantages of Atlantic City as a gambling destination stood out in high relief.<sup>86</sup> In 2014 alone, four large Atlantic City casinos, the Atlantic Club,

Trump Plaza, Revel, and Showboat, closed after going bankrupt.<sup>87</sup>

Some gambling industry analysts believe Atlantic City can recover if it broadens its selection of entertainment to compete with neighboring casino markets. New types of games, including skill-based electronic games, sports betting, and DFS, could draw in younger players. The state should also amend its gambling laws to allow for smaller "boutique" casinos that, combined with bars and restaurants, might be more attractive to certain gamblers and avoid the massive layoffs that occur when larger casinos go bankrupt. Overall, states need to rethink their legal and regulatory approach to gambling in the reality of competition and a changing market.<sup>88</sup>

## **DFS and the Future of Online Gambling**

The Unlawful Internet Gambling Enforcement Act defines fantasy sports as a "wagering" game, but exempts it from the law's proscriptions on the grounds that it is a game of skill. Indeed, there is a significant degree of skill required to win consistently at DFS.

DFS grew out of season-long fantasy sports contests that began more than 20 years ago among sports enthusiasts like John Boverly. It soon spread to other sports and became increasingly popular, especially among young men.

*The fact that some players are more skilled, better bankrolled, or put more effort into the game than others does not make the game rigged.*

At the beginning of each season, participants would create a cash prize pool, and each player would “draft” a lineup of professional athletes whom they expected would rank among the best in certain statistical categories as the season progressed. For baseball, categories would be number of home runs, runs scored, or stolen bases. For football, it could be the number of touchdowns or yardage gained running and passing. As the season progresses, fantasy teams accrue points based on the performance of their respective players. At the end of the season, the player whose team racks up the most points, or who wins the most “games” in head-to-head competition, wins the prize pool.

Legislators who voted for the fantasy sports carve-out in UIGEA say their intention was to protect these privately formed season-long fantasy games and never envisioned daily versions.

In DFS, two players can agree to compete one-on-one, or a group of players can elect to form their own “league” and compete with each other. The most popular DFS contests, however, allow individuals to compete with hundreds or thousands of players, often with multiple entries. These contests can be structured to award the million-dollar prizes touted in advertising, although there are many other ways to structure payouts, including some that pay to as many as 50 percent of entrants.

These multi-entry, multiplayer contests have drawn the most attention because deep-pocketed professionals can aggressively compete in them. Statistical samples show that the top 1 percent of players account for 40 percent of the entry fees and 91 percent of the winnings.<sup>89</sup> Furthermore, analytical software is available to help DFS players build better lineups.

While this software is available to anyone, it takes a degree of skill to know exactly what to look for. Broadly speaking, good gamblers look for positive expected value (EV)—wagering opportunities where the amount of the payoff exceeds the probability of its outcome (see sidebar). DFS software does not guarantee a win, but it does assist the player in consistently getting money down in EV-positive situations. Over the long term, this will result in wins exceeding losses.

While this has as led to accusations that DFS is unfair, in truth, it validates the industry’s contention that DFS is primarily a game of skill. Every DFS player has access to the same information. The software, tools, and information to calculate athlete value in DFS is available to all who wish to make the investment. The fact that some players are more skilled, better bankrolled, or put more effort into the game than others does not make the game rigged.

It is true that DFS advertising and promotions imply that anyone can win, but to say these claims are false is disingenuous. Casino advertising similarly shows excited players winning big jackpots, although most players fall prey to the math of house-banked games. For example, in 2015, the World Series of Poker introduced “The Colossus,” a tournament that, with a \$565 entry fee (the lowest in WSOP history), was promoted as a chance for a recreational poker player to win a coveted bracelet. That the event was won by Cord Garcia, a professional player with \$866,000 in earnings on the WSOP circuit did not lead to claims that the game was rigged or unfair.<sup>90</sup>

Because a small percentage of skilled players are winning a large share of the DFS contests, regulators have floated the idea of regulations that would prohibit the use of analytical software or limit the number of fantasy lineups a single player can enter into a contest. This, of course, would fundamentally change the nature of the game, by morphing DFS into more of a game of chance. Furthermore, it amounts to an attempt to fix something that isn’t broken.

In any event, the advantages sharp DFS players now enjoy may not last. DFS is so new that experienced sports bettors and DFS operators are each racing up the learning curve in understanding the strategy, math, and probability theory that governs the game (see sidebar).

Either way, lawmakers and regulators should be careful about incorrectly equating fairness with randomness. To be sure, some gambling games—including lotteries, slot machines, and roulette—determine winners solely on random outcomes. That means every player has the same chance of winning as another.

In other gambling games, such as video poker and card games from blackjack to poker, randomness has a role, but the outcome is determined predominately by player decisions. Saying DFS is unfair because players can use tools to identify favorable probability is like saying blackjack is unfair because some players can use a basic strategy card (something sold in every casino gift shop) to maximize wins and minimize losses—or that poker is unfair because numerous tools are available that analyze play and help players improve their game.

Mandating specific anti-fraud policies would harm the players such policies are intended to protect. Instead, DFS operators should be free to make their own policies. DraftKings and FanDuel are considering banning the use of certain third party software in conjunction with their DFS applications. Players can still use their skills, but their ability to make rapid, moment-to-moment changes in fantasy rosters across hundreds of entries in a matter of seconds would be hobbled. They are also experimenting with capping the

*Allowing the market to address imbalances in outcomes works better for everyone.*



number of entries permitted in multi-entry tournaments. Such changes would tilt the balance of DFS games toward casual players without misguided government interference.

Allowing the market to address imbalances in outcomes works better for everyone. Statistics suggest that online poker play peaked around the time UIGEA forced it to shut down. The problem was that a minority of skilled players were winning to such a degree that casual players were losing their stakes and moving on to other kinds of games.<sup>91</sup> Indeed, the slow uptake of online poker in Nevada and New Jersey underscore this point. And it is arguable that casual money players who would have once played poker online are now playing DFS.

Some business writers see the same thing occurring in DFS and are advising investors to steer clear of DFS companies. Regulatory issues aside, many worry that DFS will not be sustainable in the long run unless operators do more to limit the advantages deep-pocketed knowledgeable players have.<sup>92</sup>

This is a game management problem, not a cheating issue or “unfair” situation that regulations can remedy. In fact, outside of business failure, DFS may not be effectively shut down at this point. Lawmakers face a backlash from constituents who enjoy playing and might resent government intrusiveness. Sports leagues and television networks have banked on interest in fantasy sports to drive higher ratings.

It is likely that the industry and its partners will accept regulation in return for a stable operating environment, but that regulation must be wisely implemented, allowing competition and diversity in game selection, and with consumer protection against fraud and theft. The paramount goal of regulation should not be enforcement of subjective morality or a paternalistic urge to protect people from themselves.

Good policy begins by recognizing live and online gambling as a legitimate means of recreation and treating citizens as adults.

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