ACCEPTING DAILY FANTASY SPORTS PAYMENTS AND PROCEEDS MAY BE UNLAWFUL: NEW YORK AG ACCUSES DFS SITES OF LEADING "MASSIVE . . . SCHEME [TO] FLEECE SPORTS FANS"

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Government Enforcement Alert

New York Attorney General ("NYAG") Eric Schneiderman has claimed that daily fantasy sports ("DFS") sites, including FanDuel and DraftKings, violate New York state gambling laws. He has issued cease-and-desist letters, giving the two market-leading DFS sites only five business days to respond. This latest stinging critique of a booming industry which has found itself under fire on multiple fronts over the last three months further highlights the urgent need for financial institutions to fully evaluate their relationships with DFS sites and their users. This Alert updates and expands upon the risks first evaluated by K&L Gates LLP last month regarding DFS sites and their money-laundering potential. (*See* "Is Money Being Laundered Through Your Financial Institution Using Daily Fantasy Sports Sites?")

NYAG ISSUES CEASE-AND-DESIST LETTERS TO DFS SITES

NYAG Schneiderman dropped the proverbial hammer on FanDuel and DraftKings late Tuesday with cease-and-desist letters and an accompanying announcement that the DFS sites are in violation of the state's gambling laws.[1] Additionally, the letters allege violations of New York law regarding consumer protection—specifically, misrepresenting the likelihood of success and the skill involved, as well as "[c]onducting or transacting its business in a persistently fraudulent and illegal manner."[2] NYAG Schneiderman went further, employing pointed rhetoric to chastise the industry:

> Daily fantasy sports companies are engaged in illegal gambling under New York law, causing the same kinds of social and economic harm as other forms of illegal gambling, and misleading New York consumers. . . . Daily fantasy sports is neither victimless nor harmless, and it is clear that DraftKings and FanDuel are the leaders of a massive, multi-billion dollar scheme intended to evade the law and fleece sports fans across the country. Today we have sent a clear message; not in New York, and not on my watch.[3]

DFS sites generally claim that they do not constitute gambling because the sites offer players the opportunity to participate in games of skill, rather than games of chance, in an attempt to frame the issue and to fit within potential exceptions to federal and state legal restrictions on offering or promoting sports gambling. NYAG Eric

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Schneiderman disagrees. Relying on New York's specific anti-gaming statute, NYAG Schneiderman wrote that DFS users "are clearly placing bets on events outside of their control or influence, specifically on the real-game performance of professional athletes."[4] He further characterized the "entry fees" required by DFS sites as not-so-thinly veiled "wager[s] on a 'contest of chance' where winning or losing depends on numerous elements of chance to a 'material degree.'"[5]

DFS LEGALITY UNDER STATE LAW: SKILL OR CHANCE?

Much ink has been spilled by commentators and DFS representatives analyzing the legality of DFS sites and how these sites have been tailored to fit within the fantasy-sports exception to the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA").[6] However, the UIGEA does not make fantasy sports "legal" at the state level; DFS sites must still ensure that they operate legally under the various laws of the states in which they do business. Indeed, most DFS sites already avoid certain states because of their laws. Additionally, DFS sites may also violate federal laws, other than the UIGEA.[7]

NYAG Schneiderman used the "material degree" language above to describe the element of chance in DFS contests because, under New York state law, that is the legal standard in evaluating whether or not an activity is unlawful gambling. Requirements vary by state. It should be noted that FanDuel and DraftKings do not operate in Arizona, Iowa, Louisiana, Montana, Nevada, or Washington because of the uncertainty regarding their status under state law.[8] They continue to operate in Florida, despite an ongoing federal investigation of the industry and the pullout of other DFS sites from Florida.[9]

PRACTICAL CONSIDERATIONS FOR COMPLIANCE OFFICERS MOVING FORWARD

Financial institutions might consider taking this opportunity to review the capability of their internal controls and monitoring systems to evaluate and/or reject proceeds from DFS sites where such conduct is illegal or from potentially unlawful Internet gambling in accordance with both federal and state law. With the NYAG firing shots at DFS sites, it is easy to imagine similar focus aimed at any financial institution deemed to have aided and abetted the DFS sites, other gambling sites and/or their users where the conduct is illegal by processing or banking their payments. DraftKings and FanDuel have indicated that, even after receiving their New York cease-and-desist letters, they may continue operating in the state and are seeking court intervention.[10] FanDuel CEO Nigel Eccles stated, "New Yorkers can certainly play on FanDuel. We're going to use every avenue we can to stay open."[11]

The parallels to the online poker crackdown in 2011–12 should be obvious. As noted by the *Wall Street Journal*: "Money movement became the key factor in the criminal and civil law-enforcement violations filed against online poker companies in 2011, when the largest names in online poker were forced to stop operating in the U.S. Online poker companies had found it nearly impossible to transfer money after the federal government began to crack down on online gambling. Most financial institutions wouldn't accept payments."[12]

The current DFS uncertainty is perhaps more dangerous, because now it is not the federal government cracking down; rather, it is a patchwork of varying legal standards spread across the 50 states. Some states may prohibit

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the DFS operations entirely, while other states are comfortable with DFS sites, provided certain regulations are followed. Still other states have few restrictions on DFS sites and, indeed, appear to encourage the development of this growing and lucrative industry. With battle lines being drawn in a financial heartland (New York), financial institutions should consider thorough evaluation of their business relationship with DFS sites and their users and other sites that may constitute illegal internet gambling under state laws. Because the legality of DFS sites largely is, at present, a state law issue, financial institutions cannot rely on a one-size-fits-all approach to this industry. Individualized state assessments and analysis from lawyers uniquely situated to draw on resources and experience nationwide may be advisable to ensure compliance and mitigate the risk of potential government action.

NOTES:

[1] http://ag.ny.gov/pdfs/Final_NYAG_DraftKings_Letter_11_10_2015.pdf; http://ag.ny.gov/pdfs/Final_NYAG_FanDuel_Letter_11_10_2015_signed.pdf. Specifically, the NYAG accuses the sites of violating Article I, Section 9 of the New York State Constitution, and various sections of New York Penal Law § 225.

[2] New York Executive Law § 63(12); GBL §§ 349 and 350; and BCL § 1303.

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

[4] http://ag.ny.gov/pdfs/Final_NYAG_DraftKings_Letter_11_10_2015.pdf; http://ag.ny.gov/pdfs/Final_NYAG_FanDuel_Letter_11_10_2015_signed.pdf.

[5] *Id*.

[6] *See* 31 U.S.C. § 5362(1)(E)(ix) for the statutory language carving out the UIGEA fantasy sports exception.

[7] DFS sites potentially violate the federal Wire Act, 18 U.S.C. § 1084. Additionally, a violation of state gaming law can trigger a violation of the federal Illegal Gambling Business Act, 18 U.S.C. § 1955 . In fact, the US Attorney for the SDNY is currently investigating fantasy sports operators under federal law.

[8] http://www.legalsportsreport.com/daily-fantasy-sports-blocked-allowed-states/

[9] *Id*.; http://www.wsj.com/articles/fbi-justice-department-investigating-daily-fantasy-sports-business-model-1444865627.

[10] http://fortune.com/2015/11/11/draftkings-fanduel-new-york-schneiderman/; http://www.usatoday.com/story/sports/fantasy/2015/11/13/draftkings-lawsuit-new-york-cease-desist-order/75705742/.

[11] http://www.wsj.com/articles/fantasy-sports-site-fanduel-fights-order-to-shut-down-1447291007.

[12] *Id*.

U.S. Government Enforcement questions related to this article may be directed to any of the attorneys listed below.

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