



SCHOOL OF LAW
TEXAS A&M UNIVERSITY

Texas A&M Law Review

Volume 6 | Issue 3

2019

Modern Day Bucket Shops? Fantasy Sports and Illegal Exchanges

John T. Holden

Oklahoma State University - Main Campus, john.holden@okstate.edu

Ryan Rodenberg

Florida State University, rrodenberg@fsu.edu

Follow this and additional works at: <https://scholarship.law.tamu.edu/lawreview>



Part of the [Gaming Law Commons](#), and the [Securities Law Commons](#)

Recommended Citation

John T. Holden & Ryan Rodenberg, *Modern Day Bucket Shops? Fantasy Sports and Illegal Exchanges*, 6 Tex. A&M L. Rev. 619 (2019).

Available at: <https://doi.org/10.37419/LR.V6.I3.2>

This Article is brought to you for free and open access by Texas A&M Law Scholarship. It has been accepted for inclusion in Texas A&M Law Review by an authorized editor of Texas A&M Law Scholarship. For more information, please contact aretteen@law.tamu.edu.

MODERN DAY BUCKET SHOPS? FANTASY SPORTS AND ILLEGAL EXCHANGES

by: John T. Holden* & Ryan M. Rodenberg**

ABSTRACT

The rapid emergence of online daily fantasy sports has raised questions as to why the contests are allowed, while other forms of gambling are restricted. Historically, “bucket shops” were banned enterprises where businesses would effectively accept wagers on whether companies’ stock prices would go up or down. There was never an underlying investment in companies themselves, only a deposit into a “bucket.” While bucket shops have largely faded, we examine whether they have disappeared in name only. Our analysis opens up another avenue for regulators beyond the antiquated skill-versus-chance evaluation typically applied to gambling activities and suggests that certain fantasy contests may run counter to Commodity Futures Trading Commission regulations. Applying this existing regulatory framework would likely enhance consumer protection and market integrity.

TABLE OF CONTENTS

I. INTRODUCTION.....	620
II. MARKET REGULATION.....	622
A. <i>Aleatory Contracts</i>	623
B. <i>Regulation of Sports Gambling</i>	625
C. <i>Sports Betting Funds</i>	627
D. <i>The Daily Fantasy Marketplace</i>	628
III. THE ROLE AND EVOLUTION OF THE CFTC.....	630
A. <i>Old Markets, New Products</i>	632
B. <i>Illegal Exchange Activities</i>	633
IV. DAILY FANTASY SPORTS WEBSITES AND PROHIBITED ACTIVITIES.....	640
A. <i>Do DFS Sites Fall Under the Purview of the CFTC?</i>	642
B. <i>What If the CFTC Asserts Jurisdiction?</i>	646
V. CONCLUSION	651

* John T. Holden is an Assistant Professor in the Spears School of Business at Oklahoma State University.

** Ryan M. Rodenberg is an Associate Professor at Florida State University.
DOI: <https://doi.org/10.37419/LR.V6.I3.2>

*“We make our money as any other marketplace business does. We match effectively buyers and sellers together.”*¹

– Matt King, FanDuel executive

*“[I]t’s a lot harder to beat a business than it is to beat one person.”*²

– Peter Jennings, fantasy and sports betting expert

I. INTRODUCTION

Regulating new financial products poses a challenge for the federal government, particularly when the product does not neatly fit within the classification of any existing concept or term. The Daily Fantasy Sports (“DFS”) industry appears closely tied to sports gambling when looked at from a casual observer’s perspective; however, many types of commonly used investment products may also appear to have elements of gambling.³ The federal government often treats sports gambling and derivative products differently than traditional stock market investments, even though the government cannot sufficiently differentiate between these activities—at least in determining whether the activity is skill- or luck-based.⁴ Those who suggest that sports gambling offers a meaningful opportunity for investors to hedge against risk and maintain a diversified investment portfolio may facilitate a transition from the treatment of sports gambling as a societal plague to an activity that allows investors a lucrative opportunity to balance other financial commitments.⁵ Presently, the DFS industry remains devoid of

1. Jason M. Breslow, *Matt King: Daily Fantasy Sports Are “Entertainment,” Not Gambling*, PBS FRONTLINE (Feb. 9, 2016), <http://www.pbs.org/wgbh/frontline/article/matt-king-daily-fantasy-sports-are-entertainment-not-gambling> [https://perma.cc/E5WP-4GF2].

2. Dan Barbarisi, *DraftKings and FanDuel Bet They’re Ready for a Second Act; Can They Take Over Sports Gambling?*, ATHLETIC (June 4, 2018), <http://www.theathletic.com/377565/2018/06/04/draftkings-and-fanduel-bet-theyll-have-a-second-act-can-they-take-over-sports-betting> [https://perma.cc/A2CE-L88Y].

3. Gambling is generally considered to have three elements: prize, chance, and consideration. See Anthony N. Cabot & Louis V. Csoka, *Fantasy Sports: One Form of Mainstream Wagering in the United States*, 40 J. MARSHALL L. REV. 1195, 1203 (2007).

4. See Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling, and the Speculation Paradox*, 86 B.U. L. REV. 371, 387–88 (2006).

5. See Michael C. Macchiarola, *Rethinking Sports Wagering*, 85 IND. L.J. SUPP. 1, 6, 8 (2010) (addressing the roadblocks created by the Professional and Amateur Sports Protection Act, or “PASPA,” which was recently held to be unconstitutional by the Supreme Court in *Murphy v. Nat’l Collegiate Athletic Ass’n*, 138 S. Ct. 1461, 1484–85 (2018), and arguing for the regulation of sports wagering under the federal securities laws). See also Michael C. Macchiarola, *Securities Linked to the Performance of Tiger Woods? Not Such A Long Shot*, 42 CREIGHTON L. REV. 29 (2008) (discussing the divergence between gambling and typical investment vehicles and the disparate treatment of sports wagering under federal regulations); Jeffrey Standen, *The Beauty of Bets: Wagers as Compensation for Professional Athletes*, 42 WILLAMETTE L. REV. 639 (2006) (providing an insightful discussion of sports betting and in the world of fantasy leagues and suggesting that sports leagues’ rationales for banning gambling do not justify certain prohibitions); Christopher T. Pickens, *Of Bookies and*

regulation at the federal level.⁶ But while no federal agency has asserted regulatory jurisdiction over the DFS industry, there nevertheless exists the possibility that certain DFS contests violate laws and regulations within the regulatory purview of the Commodity Futures Trading Commission (“CFTC”).

DFS contests have been around in some form for close to a decade, but only in the last four years did the games rise to prominence.⁷ Unlike traditional fantasy sports, which Americans have played in various forms for several decades and take place over the length of an entire sports season, DFS contests take place over a period of time as short as an afternoon.⁸ There are a variety of different DFS contests that companies offer, though customers play three types most frequently: (1) guaranteed prize pools (“GPPs”); (2) 50/50s; and (3) head-to-head games.⁹ GPPs are large-scale tournaments where thousands of competitors can compete for prizes by selecting fantasy lineups and competing against others in the pool.¹⁰ The payout for the winner of a GPP can be upwards of seven figures, but prizes are typically reserved for only the contest’s top competitors [or finishers].¹¹ The 50/50s, also referred to as double-ups, are pool games where the top half of competitors in a contest double their money, whereas those in the bottom half of the pool walk away with nothing.¹² Head-to-head contests are one-on-one, peer-to-peer contests with users competing directly against one another and the winner receiving a pre-set amount of money that is less than the combined entry fees.¹³ The pri-

Brokers: Are Sports Futures Gambling or Investing, and Does It Even Matter?, 14 GEO. MASON L. REV. 227, 247–56 (2006) (arguing against the “gambling-investing dichotomy”).

6. This Article is focused on regulation of the DFS industry at the federal level, but there are also great disparities in the treatment of DFS among the states, ranging from complete legality to complete illegality. See Dustin Gouker, *Legislative Tracker: Daily Fantasy Sports*, LEGAL SPORTS REP., <http://www.legalsportsreport.com/dfs-bill-tracker> (last visited Feb. 25, 2019) [<https://perma.cc/C9L4-RCQJ>] (providing details on state-by-state regulation of daily fantasy sports).

7. John T. Holden & Simon A. Brandon-Lai, *Advertised Incentives for Participation in Daily Fantasy Sports Contests in 2015 and 2016: Legal Classifications and Consumer Implications*, 15 ENT. & SPORTS L.J., Oct. 4, 2017, at 1–3.

8. Marc Edelman, *Navigating the Legal Risks of Daily Fantasy Sports: A Detailed Primer in Federal and State Gambling Law*, 2016 U. ILL. L. REV. 117, 127–29 (2016) (describing the categories of DFS contests).

9. Nathaniel J. Ehrman, *Out of Bounds?: A Legal Analysis of Pay-to-Play Daily Fantasy Sports*, 22 SPORTS L.J. 79, 86 (2015).

10. *Id.*

11. *See id.*

12. *Id.* The amount won is typically reduced by a commission or “rake” held by the DFS company. See Dustin Gouker, *Rake Goes up at DraftKings, FanDuel for NFL Week 4, and Users Aren’t Happy*, LEGAL SPORTS REP. (Sept. 26, 2017, 8:12 PM), <http://www.legalsportsreport.com/15721/draftkings-fanduel-rake-increases> [<https://perma.cc/2TFA-JUPM>].

13. See Ehrman, *supra* note 9. The head-to-head games have been criticized for several reasons including their potential to be used for money laundering and the practice of “bumhunting” whereby experienced users would target newer, less-exper-

mary focus of this Article is head-to-head games—a close cousin to the format of stock markets and betting exchanges—but this Article does tangentially address other DFS contests.

This Article is organized into three sections followed by a conclusion. In Section II, we explore the historical treatment of financial products and their relationship to gambling. In Section III, we discuss the scope of the CFTC's jurisdiction and provide an overview of how DFS games are structured. In Section IV, we analyze whether certain DFS contests are within the CFTC's jurisdiction by virtue of their structure. We conclude with policy suggestions, including suggestions for potential regulations associated with the use and misuse of inside information, which could protect contest integrity and boost consumer confidence in the industry.

II. MARKET REGULATION

In the United States prior to 1950, both the federal and state governments widely prohibited most gambling.¹⁴ The preexisting federal gambling prohibitions eventually gave way to limited forms of legalized gambling at the federal level, provided that gambling operators complied with an excise tax.¹⁵ While the federal government implemented the excise tax to generate revenue, the Supreme Court held the accompanying disclosure requirements to be unconstitutional under the Fifth Amendment.¹⁶ The modern trend has been to leave regulation of gambling to the states. While a model anti-gambling code was proposed in 1952 by a committee of the American Bar Association, many states chose to define gambling individually, leading to various states criminalizing different activities.¹⁷

The internet has complicated regulation at both the intrastate and interstate levels, as well as internationally where “borderless industries” like online gambling are the beneficiaries of the global interconnection enabled by the internet.¹⁸ While such industries benefit from the technological revolution, nation-states do not.¹⁹ In 2011, the United States and United Kingdom accounted for 50% of the global gambling revenues despite broad prohibitions on internet gambling in

enced players. See John T. Holden et al., *Daily Fantasy, Tipping, and Wire Fraud*, 21 GAMING L. REV. & ECON. 8, 9–10 (2017).

14. G. Robert Blakey, *Legal Regulation of Gambling Since 1950*, 474 ANNALS AM. ACAD. POL. SCI. & SOC. SCI. 12, 13 (1984).

15. *Id.* at 16.

16. See *id.* (first citing *Marchetti v. United States*, 359 U.S. 39 (1968); and then citing *Grosso v. United States*, 390 U.S. 62 (1968)).

17. *Id.* at 19–21. See also Ryan Rodenberg, *Why Do States Define Gambling Differently?*, ESPN (Feb. 18, 2016), http://www.espn.com/chalk/story/_id/14799507/daily-fantasy-why-do-states-define-gambling-differently [https://perma.cc/FE2R-8K85].

18. Betsi Beem & John Mikler, *National Regulations for a Borderless Industry: US Versus UK Approaches to Online Gambling*, 30 POL'Y & SOC'Y 161, 161–63 (2011).

19. *Id.* at 161.

the United States.²⁰ While the United States and the United Kingdom represent a majority of the gambling market, the two nations have different means of regulation; some are a result of American constitutionalism (e.g., federalism and state regulation), and others are matters of federal prerogatives.²¹ In addition to various approaches to regulating gambling, a historical connection exists between gambling transactions and certain financial products.

Some have observed a trend in the media's discussion of legalized sports betting during the emergence of DFS and its growth as an industry, with advocates for legalization often arguing that the practice is no different than an investor trading stocks through an online brokerage account.²² However, this likening is far from a perfect fit, and the distinction between gambling in DFS contests and financial investing is complicated.²³ The difference, as described by *Washington Post* columnist Norman Chad, is that while sports gambling, DFS, and investing in stocks are all forms of gambling, DFS and stock market investments are not illegal.²⁴

A. Aleatory Contracts

The definition of an "aleatory contract" as "a contract whose execution or performance is contingent upon the occurrence of a particular event or contingency or an uncertain (random) event beyond the control of either party"²⁵ appears to apply as much to a home owner's insurance contract that pays following the unexpected destruction of the home by fire as it does to a betting contract on the winner of next year's Super Bowl.²⁶ The most common aleatory contracts are various forms of insurance contracts. While common types of insurance (e.g.,

20. *Id.* at 162. A variety of federal statutes form a venerable obstacle to widespread legal online gambling in the United States. See Ryan M. Rodenberg & Anastasios Kaburakis, *Legal and Corruption Issues in Sports Gambling*, 23 J. LEGAL ASPECTS SPORT 8, 10–17 (2013).

21. Beem & Mikler, *supra* note 18, at 172–73.

22. See Grange95, *Drawing the Line Between Gambling and Finance: Part I—Meet the Aleatory Contracts*, CRAAKKER (Mar. 8, 2015, 11:16 PM) [hereinafter *Aleatory Contracts*], <http://craakker.blogspot.com/2015/03/drawing-line-between-gambling-and.html> [https://perma.cc/Y3DL-TDP3]. DFS games have been compared to a number of different activities, with stock trading being one these activities. See Dustin Gouker, *The Daily Fantasy Sports Analogy Game; Or Why DFS Is Not Like a Spelling Bee*, US POKER (Jan. 5, 2016), <http://www.uspoker.com/blog/daily-fantasy-sports-analogies/13204> [https://perma.cc/8CFC-SGSX].

23. *Id.*

24. Norman Chad, *Couch Slouch: Fantasy Sports Are as Much Gambling as Sports Betting*, WASH. POST (Jan. 11, 2015), http://www.washingtonpost.com/sports/couch-slouch-fantasy-sports-are-as-much-gambling-as-sports-betting/2015/01/11/2b11f364-99b9-11e4-a7ee-526210d665b4_story.html [https://perma.cc/3GFP-3JCS].

25. See *Aleatory Contracts*, *supra* note 22 (citing *Aleatory Contract Law and Legal Definition*, USLEGAL, <http://definitions.uslegal.com/a/aleatory-contract> (last visited Feb. 17, 2019) [https://perma.cc/FG39-FU3V]).

26. See *id.*

life, home, and auto) are widely known and accepted parts of organized social life, almost anything can be insured for a price.²⁷ The premium paid in an insurance contract acts as a wager that an uncertain event will happen.²⁸ Additionally, insurance companies engage in the practice of risk pooling—similar to a casino—whereby the total amount of money is taken in and then used to pay out winners or insureds who suffer a loss.²⁹ Both the insurance company and casino operate on the premise that the whole amount paid in will exceed the amount that is distributed out.³⁰

The historical differentiator between activities deemed economically beneficial and those deemed to be gambling is whether the activity balances offering financial hedging opportunities while not striding too far into the depths of wild speculation.³¹ In *Grigsby v. Russell*, the Supreme Court found that life insurance contracts held by third parties create “a sinister counter-interest in having the life come to an end.”³² The holding in *Grigsby*—that insurance policies were simply pieces of property—has created unique market events such as the one in the 1980s when AIDS patients sold their life insurance contracts to speculators for more than the cash value of the policies but below the amount of the policies’ death benefits.³³

DFS contests represent a form of derivative contracts, as they include an activity whereby value is derived from an underlying sporting event.³⁴ The presence of chance in a given athlete’s performance on any given day and the amount paid to enter a DFS contest render the practice a form of aleatory contract.³⁵ The separation of DFS as an acceptable and marketable derivative of an underlying sporting event—while sports gambling largely remains unacceptable and un-

27. See Grange95, *Drawing the Line Between Gambling and Finance: Part II—Insurance: Gambling on Catastrophe*, CRAAKKER (Mar. 9, 2015, 7:18 AM) [hereinafter *Gambling on Catastrophe*], http://craakker.blogspot.com/2015/03/drawing-line-between-gambling-and_9.html [https://perma.cc/9687-D8FB].

28. *Id.*

29. *Id.* While beyond the scope of this Article, DFS companies who offer GPPs are likely engaged in a form of risk pooling. Indeed, in November 2018, one DFS operator introduced a product called “pools.” See Eric Ramsey, *New DraftKings Sportsbook Pools Offer Jackpot-Style NJ Sports Betting Contests*, LEGAL SPORTS REP. (Nov. 8, 2018, 6:23 AM), <https://www.legalsportsreport.com/25720/draftkings-sportsbook-pools-launch/> [https://perma.cc/PGB2-NSL8].

30. *Gambling on Catastrophe*, *supra* note 27.

31. See Grange95, *Drawing the Line Between Gambling and Finance: Part V—Hedgers and the Law*, CRAAKKER (Mar. 25, 2015, 10:40 PM), http://craakker.blogspot.com/2015/03/drawing-line-between-gambling-and_25.html [https://perma.cc/SHN6-K95J].

32. *Id.* (quoting *Grigsby v. Russell*, 222 U.S. 145, 154–55 (1911)).

33. *Id.*

34. See Grange95, *Drawing the Line Between Gambling and Finance: Part IV—Derivatives and Daily Fantasy Sports*, CRAAKKER (Mar. 11, 2015, 1:55 PM), http://craakker.blogspot.com/2015/03/drawing-line-between-gambling-and_11.html [https://perma.cc/8RWZ-CC78].

35. *Id.*

marketable when other derivative products, including weather-based products, are acceptable in a separate but related context—poses a curious question as to what makes sports gambling historically different in the eyes of the law.³⁶ Other countries have allowed for the emergence of sports betting markets that operate similarly to traditional stock exchanges with regard to regulation.³⁷

A wide variety of commercial transactions involve elements of chance and may be considered gambling to someone not familiar with the transaction.³⁸ Lawmakers have occasionally recognized the gambling characteristics present in some non-gambling financial transactions and activities as noted by exemptions in a number of federal laws.³⁹ A variety of investment strategies that are similar to gambling include speculative investments, index funds with no physical delivery date, and event futures.⁴⁰ The Federal Trade Commission, for example, initially referred to multi-level marketing platforms as pyramid schemes and shut them down, but many of those platforms are now regarded as legitimate businesses.⁴¹ In addition to these commercial transactions, many poorly understood activities were initially classified as gambling but transitioned to accepted and legitimate forms of investment when properly regulated.⁴²

B. Regulation of Sports Gambling

The regulation of the sports gambling industry, including semantically differentiated products such as DFS, takes varying forms. The complexity of shared federal and state power in the United States presents an additional challenge to implementing a regulatory model.⁴³ While traditional bookmaker-style betting remains the most prominent legal form of sports gambling in the United States, betting exchanges are popular in other countries and allow a participant to either set lines like a bookmaker or act as a bettor.⁴⁴

36. *Id.*

37. See Mark Davies et al., *Betfair.com: Five Technology Forces Revolutionize Worldwide Wagering*, 23 EUR. MGMT. J. 533 (2005).

38. See I. NELSON ROSE & MARTIN D. OWENS, JR., *INTERNET GAMING LAW* 46 (2d ed. 2009).

39. *Id.* at 60.

40. *Id.* at 44–49.

41. *Id.* at 45–46.

42. See MICHAEL ABRAMOWICZ, *PREDICTOCRACY: MARKET MECHANISMS FOR PUBLIC AND PRIVATE DECISION MAKING* 49 (2007).

43. See, e.g., Beem & Mikler, *supra* note 18. Indeed, the reliance on state laws as the primary source of law in determining whether an activity is gambling results in different activities being legal in different states. See John T. Holden, *Mailbag Mythbusting: The Illegal Gambling Businesses Act and Sports Betting*, SPORTS HANDLE (June 18, 2018, 11:30 AM), <https://sportshandle.com/mailbag-mythbusting-the-illegal-gambling-businesses-act-and-sports-betting> [<https://perma.cc/R6SM-TREP>].

44. See generally COLIN CAMERON, *YOU BET THE BETFAIR STORY: HOW TWO MEN CHANGED THE WORLD OF GAMBLING* (2011).

The rise of betting exchanges such as Betfair has been complicated in some jurisdictions, in part, due to reluctance to depart from traditional market structures of bookmaking.⁴⁵ The betting exchange market represents an opportunity for transparency because price movements provide information not present in the traditional bookmaker model where such movements are often more opaque to public domain observers.⁴⁶ A 2003 policy paper, published by the UK's Department for Culture Media and Sport ("DCMS"), proposed that betting exchanges be subjected to the rules of traditional licensed betting operators in addition to six special rules: (1) the exchange operator cannot initiate any bets; (2) customers cannot be known to other customers; (3) the exchange rules must be visible and disseminated; (4) operators must consent to payment processing auditing by the licensing commission; (5) operators must separate betting accounts and operating accounts; and (6) exchanges are subject to the same regulation as other gambling providers operating over the internet.⁴⁷

While the proposed rules would provide transparency, the UK DCMS recommended that licenses not be required for individuals setting propositions on exchanges, thereby providing some protection to the commercial viability of the product.⁴⁸ British lawmakers rejected the proposed regulations because they favored requiring licensure for those proposing a betting transaction.⁴⁹ While Betfair remains the most recognized betting exchange globally, its efforts to expand have been stifled in part by aggressive taxation schemes (Australia) and bureaucratic indecision (United States).⁵⁰ Betfair has struggled to enter these legal markets even though its business structure has reframed the conceptualization of sports wagering.

The Betfair peer-to-peer model that allows bettors to pick a loser—comparable to taking a short position in a stock—was a meaningful innovation absent in then-existing legal markets.⁵¹ As a result of Betfair's design—in not collecting the traditional vigorish on each wa-

45. See Niall O'Connor, *A Short History of the Betting Exchange Industry*, BETTINGMARKET (2017), <http://www.bettingmarket.com/refraichir010388.htm> [https://perma.cc/A8QW-VMNJ].

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. See *id.* In 2013, Betfair applied for a license to offer exchange wagering on horseracing in California, but the application was rejected. See Steve Anderson, *Exchange Betting Rules Rejected by California Office of Administrative Law*, DAILY RACING FORM (Mar. 21, 2013, 1:25 PM), <http://www.drif.com/news/exchange-betting-rules-rejected-california-office-administrative-law> [https://perma.cc/W3MV-6FSZ]. In 2015, Betfair was granted a license to operate a horseracing exchange in New Jersey. See Katie Barlowe, *Betfair Receives New Jersey Betting Exchange License*, CASINO.ORG (Nov. 23, 2015), <http://www.casino.org/news/betfair-receives-new-jersey-betting-exchange-license> [https://perma.cc/TU7T-Z3XV].

51. Davies et al., *supra* note 37, at 533.

ger—a bettor needs to succeed at a much lower rate to be profitable.⁵² The Betfair model may also increase transparency by placing the company in the role of facilitator instead of bookmaker.⁵³ The emergence of Betfair and other betting exchanges, such as Smarkets, has signaled a transition from traditional conceptualizations of bookmaking.⁵⁴ While Betfair remains a prominent market overseas, the United States has remained cautious in the regulation of exchange-style sports wagering. Nevertheless, American customers may already be participating in exchange-type markets given the structure of certain DFS head-to-head contests.⁵⁵

C. Sports Betting Funds

In addition to the use of exchange-based wagering as an alternative or complimentary activity to stock market investing, several companies have developed entity-betting funds that “invest” in sport as an asset class and frequently participate on betting exchanges.⁵⁶ The managers of the Galileo Managed Sports Fund marketed the fund as the “first regulated sports fund in the world.”⁵⁷ In January 2012, the Galileo fund announced to investors that the fund lost \$2.5 million and was to be liquidated by creditors.⁵⁸ The letter to investors attributed Galileo’s losses to “sheer bad luck.”⁵⁹

The Priomha Group is another managed sports fund. In 2011, Priomha noted that betting exchanges transformed sports betting to an

52. *Id.*

53. *Id.* at 538.

54. See O’Connor, *supra* note 45. See also SMARKETS, <https://smarkets.com> (last visited July 9, 2018) [<https://perma.cc/6QRZ-QNXX>].

55. Following its recent acquisition of FanDuel, Paddy Power Betfair signed a deal to operate a variety of sportsbooks in New Jersey. The entry into the US market does not presently include the same exchange-based sports betting platform that is available in other jurisdictions. Dustin Gouker, *Betfair US Inks NJ, NY Sports Betting Deals; FanDuel ‘Very Likely’ to Be Used as Primary Brand*, LEGAL SPORTS REP. (June 7, 2018, 4:18 PM), <http://www.legalsportsreport.com/21046/betfair-nj-and-ny-sports-betting> [<https://perma.cc/BQ8A-QQ7P>].

56. See Cullen D. Manning, *Sports Betting After Sabermetrics: The Case for Applying PASPA Restrictions to Betting Groups*, 3 MISS. SPORTS L. REV. 261, 266–68 (2014). Indeed, Yale professor Tobias Moskowitz posited that sports betting is a unique asset class. See Tobias J. Moskowitz, *Asset Pricing and Sports Betting* 35 (Working Paper No. 120, Chi. Booth Sch. of Bus. Research Paper Series, Paper No. 15-26, 2015).

57. See Galileo Managed Sports Fund, *A Regulated Absolute Return Sports Fund – Fund Fact Sheet*, CENTAUR GALILEO 1–35 (July 8, 2010) (on file with Authors).

58. See Tony Manfred, *The World’s First Sports-Betting Hedge Fund Has Collapsed After Losing \$2.5 Million*, BUS. INSIDER (Jan. 31, 2012, 10:32 AM), <http://www.businessinsider.com/sports-betting-hedge-fund-collapses-2012-1> [<https://perma.cc/SH9Q-V64P>].

59. *Id.*

investment opportunity and an alternative forum to manage risk.⁶⁰ Sports funds, like Galileo and Priomha, often trade via betting exchanges—a strategy that mimics stock traders.

While Betfair remains the most prominent betting exchange, it was predated by the Irish-based market known as Intrade. The Intrade platform allowed traders to take either side of a proposition on nearly any global event, paying the winner in increments of \$10.⁶¹ Intrade was lauded for its predictive accuracy, which included successfully outperforming experts and traditional polls in determining the United States Presidential Electoral College vote in 2008.⁶² In addition to showing predictive accuracy, Intrade was able to attract a wide variety of investors, including sophisticated Wall Street managers, professional gamblers, and followers of politics.⁶³ The demise of Intrade occurred shortly after the 2012 U.S. presidential election when the CFTC accused Intrade of violating the agency's regulations.⁶⁴ Intrade's investors became aware of the company's problems following the death of top executive John Delaney when they discovered that Delaney had amassed large amounts of personal debt.⁶⁵ As Intrade's internal problems mounted, so too did the external forces of a CFTC lawsuit filed in United States federal court.⁶⁶ Ron Bernstein, a former Intrade executive, noted that the Intrade strategy of "regulatory avoidance isn't a good business model."⁶⁷ While Intrade's cessation of operations resulted from a combination of internal and external pressures, its predictive accuracy and market liquidity make a return of a market-structured entity similar to Intrade likely.⁶⁸

D. *The Daily Fantasy Marketplace*

Sports betting and trading in individual stocks are within the same category of activities on a skill-chance continuum;⁶⁹ both "are passive wagers on the future actions of others."⁷⁰ Stock prices and sports wagers are influenced by a multitude of external factors beyond the bettor's control, regardless of the amount of research informing the

60. See The Priomha Grp., *CLONEY Multi-Sport Investment Fund*, AUSTRALIAN SPORTS BETTING (Dec. 2011), http://www.aussportsbetting.com/files/CLONEY_Fund_Factsheet_Decl_2011.pdf [<https://perma.cc/H77M-M3AN>].

61. Andrew Rice, *The Fall of Intrade and the Business of Betting on Real Life*, BUZZFEED (Feb. 20, 2014, 11:25 PM), <http://www.buzzfeed.com/andrewrice/the-fall-of-intrade-and-the-business-of-betting-on-real-life#.lv1LKVAwJ> [<https://perma.cc/TJE3-3UUC>].

62. See *id.*

63. *Id.*

64. See *id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. See Hurt, *supra* note 4, at 378.

70. *Id.* at 387.

bettor's selection.⁷¹ Like a bookmaker, most casual stock investors buy and sell stocks through a market-maker.⁷² Similar to poker players and sports bettors, the investors who maintain consistent profitability are largely professional.⁷³ DFS operators have been positioning the contests they offer as games of skill.⁷⁴ The DFS model tries to position the contests to be skill-based in order to avoid some state gambling laws.⁷⁵ The skill versus chance dichotomy does not establish legality in all states, but supports a plurality of states choosing not to consider an activity as gambling. The challenge for DFS operators is that DFS requires less skilled players to play and lose against more skilled players in order to maintain a viable market.⁷⁶ Conservative estimates, based on one analysis, showed that skilled participants won more than 70% of the time against less skilled opponents.⁷⁷ As the number of fraud-related private lawsuits against DFS companies rose, additional studies showing that only a small number of individuals consistently win may make it difficult for DFS companies to attract new participants and, in turn, establishing a sustainable business model.⁷⁸

The exchange-based format that has become a prominent form of sports betting in Europe is not operating with the same level of prominence in the United States. While this may be explained by the rela-

71. *Id.*

72. *Id.* at 389. A market maker is capable of both selling and buying shares at specific prices. See Joshua Kennon, *What Is a Market Maker and How Do They Make Money*, BALANCE, <http://www.thebalance.com/what-is-a-market-maker-and-how-do-they-make-money-4053753> (last visited Dec. 30, 2018) [<https://perma.cc/7R8B-YBY2>].

73. See Hurt, *supra* note 4, at 391.

74. See Ed Miller & Daniel Singer, *For Daily Fantasy Sports Operators, the Curse of Too Much Skill*, SPORTS BUS. J. (July 27, 2015), <https://www.sportsbusinessdaily.com/Journal/Issues/2015/07/27/Opinion/From-the-Field-of-Fantasy-Sports.aspx> [<https://perma.cc/D8AB-Y3J3>].

75. See Thomas J. Miles et al., *Is Texas Hold 'Em a Game of Chance? A Legal and Economic Analysis*, 101 GEO. L.J. 581, 588 (2013).

76. See Miller & Singer, *supra* note 74.

77. See Ana Swanson, *The Future of Fantasy Sports Hinges on Whether Winners Are Skilled — Or Just Lucky*, WASH. POST (Oct. 19, 2015), <http://www.washingtonpost.com/news/wonk/wp/2015/10/19/the-future-of-fantasy-sports-depends-on-whether-winners-are-skilled-or-just-lucky> [<https://perma.cc/SU4L-M63S>].

78. While a number of DFS companies have cited and commissioned studies attesting to the level of skill in their games, all known studies have been based on a potentially flawed methodology, examining performance over time. Given that the “D” in DFS stands for “Daily,” a longitudinal analysis seems ill-suited as each DFS contest occurs in isolation, where even a total novice could beat a more skilled individual who has devoted his or her life to DFS. Federal authorities investigating DFS companies could probe whether individual contests constitute games of skill or chance, as opposed to a longitudinal analysis of whether more skilled players succeed at a higher rate over time. The fact that in any individual contest on any given day any DFS player can win was acknowledged by Professor Anette Hosoi during a 2016 panel at the MIT Sloan Sports Analytics Conference. See 42 Analytics, *SSAC16: Luck vs. Skill: Gambling Analytics*, YOUTUBE (Apr. 21, 2016), <https://www.youtube.com/watch?v=com6Q1nHiWVc&t=1s> [<https://perma.cc/9TQC-ZL2T>].

tively nascent sports betting expansion following the Supreme Court's ruling in *Murphy v. NCAA*,⁷⁹ the possibility that certain DFS contests may be operating contrary to federal law and regulations was raised.⁸⁰ The DFS contests that have grown in popularity of late are distinctly different from season-long leagues because the DFS contests possess daily market action—a feature that is regulated in “almost all” other markets.⁸¹ Many DFS contests use mark-to-market scoring to estimate current value, which is similar to the accounting methods used by products on futures exchanges.⁸² When estimating an athlete's fantasy value on a given night, DFS companies assign a present estimate of the player's worth, as opposed to traditional scoring methods based on accrual scoring that requires previous events to complete prior to assigning value.⁸³ Neither the presence of mark-to-market scoring nor daily market action render an activity an illegal exchange on its own; however, several other features of DFS games may render them susceptible to the regulations of financial regulators. These features include matching buyers with sellers and offering sports-based derivatives, which the Dodd–Frank Wall Street Reform Act of 2010 (“Dodd–Frank Act”) may classify as prohibited event contracts.⁸⁴

III. THE ROLE AND EVOLUTION OF THE CFTC

The purpose of financial market regulation was to provide investors with access to relevant information in order to make informed decisions.⁸⁵ Derivatives are items that develop their value from an under-

79. *Murphy v. Nat'l Collegiate Athletic Ass'n*, 138 S. Ct. 1461 (2018) (striking down the partial federal sports betting ban in the Professional and Amateur Sports Protection Act as unconstitutional).

80. See generally Kevin Braig et al., *Unsure Bet: The Future of Daily Fantasy Exchange Wagering*, 17 GAMING L. REV. & ECON. 499 (2013).

81. *Id.* at 499.

82. *Id.* at 503. Mark-to-market valuation attempts to provide an appraisal of value based on “current market value” as opposed to “book value.” The term was coined by Professor Matt Holden of the University of Nevada Las Vegas and can be used interchangeably with “fair value accounting.” See *Mark to Market Accounting, Definition*, NASDAQ, <http://www.nasdaq.com/investing/glossary/m/mark-to-market-accounting> (last visited Dec. 30, 2018) [<https://perma.cc/V3B2-F72Z>].

83. Braig et al., *supra* note 80, at 503–04. Many DFS games confine users to a salary-cap whereby DFS players have to select athletes to fill their teams while composing a roster of players with company-established values that does not exceed a certain level.

84. This very concept of matching buyers and sellers was mentioned by a FanDuel executive in a 2016 interview with PBS Frontline. See Breslow, *supra* note 1. (“We make our money as any other marketplace business does. We match effectively buyers and sellers together. What we are is similar to eBay. Where their role was to facilitate the auction of goods, our role is to frankly bring people together that want to compete in the same game.”).

85. See Thomas Lee Hazen, *Rational Investments, Speculation, or Gambling?—Derivative Securities and Financial Futures and Their Effect on the Underlying Capital Markets*, 86 Nw. U. L. REV. 987, 987 (1992).

lying security, asset, or index.⁸⁶ Derivatives exist in two types: futures and option contracts. These differ in that a futures contract creates an obligation to deliver the underlying commodity for a certain price at a certain date, whereas an option contract does not “create delivery obligations unless and until the option-holder exercises the option.”⁸⁷ Commodities markets provide three material benefits for investors: “(1) risk allocation, (2) price discovery—which results in more accurate pricing of the underlying commodity, and (3) a more accessible source of pricing information.”⁸⁸ Options on these underlying commodities then present a meaningful opportunity for investment firms to hedge against the risk of the underlying product.⁸⁹ Additionally, derivative markets generate useful information for allocating resources and reducing the transaction costs for the trading of financial instruments.⁹⁰ While DFS and sports gambling presently may appear, on the surface, to be outside the regulatory scope of the CFTC and Securities and Exchange Commission (“SEC”), both agencies have historically sought to encourage development of new financial instruments, which could potentially place DFS or sports gambling within the agencies’ scope in the future.⁹¹

The emergence of new financial products has sometimes led to conflicts between the SEC and CFTC over regulatory authority.⁹² Two types of investors typically trade in the futures market: (1) hedgers seeking to lessen the risk of other investments; and (2) speculators seeking a large profit without any intention of taking future delivery of a product.⁹³ A 1982 accord between the CFTC and SEC determined the regulatory jurisdiction of each body.⁹⁴ While controversial issues remain regarding where the SEC’s jurisdiction ends and the CFTC’s jurisdiction begins, the CFTC assumed jurisdiction over futures derivatives.⁹⁵ While the CFTC and SEC have many similarities, the CFTC lacks the broad independence of the SEC and is tightly constrained by budget allocations.⁹⁶ According to one researcher, the CFTC has been unable or unwilling to define the exact contours of its

86. *Id.* at 989.

87. *Id.* at 990.

88. *Id.* at 1007.

89. *Id.* at 1010.

90. *Id.* at 1008–09.

91. *Id.* at 1021.

92. See generally John D. Benson, *Ending the Turf Wars: Support for a CFTC/SEC Consolidation*, 36 VILL. L. REV. 1175 (1991).

93. *Id.* at 1178.

94. *Id.* at 1187–88. The CFTC was awarded jurisdiction of “all futures contracts, options on futures, stock index futures and options on stock index futures, while the SEC was to have authority over options on securities and options on stock indices.” *Id.* at 1188.

95. See generally Alton B. Harris, *The CFTC and Derivative Products: Purposeful Ambiguity and Jurisdictional Reach*, 71 CHI.-KENT L. REV. 1117 (1996).

96. *Id.*; Benson, *supra* note 92, at 1717–18.

regulatory authority in the derivatives market, often issuing ambiguous rulings so as to not offend either side of disputes over the particulars of its authority.⁹⁷

Different congressional committees oversee the SEC and CFTC. The CFTC's connection to traditional agricultural-based commodities has occasionally caused disputes with the SEC over new derivatives products.⁹⁸ Certain financial innovators have crafted products so as to lower regulatory costs by having the products regulated by either the SEC or CFTC.⁹⁹ The derivatives markets regulated by the CFTC reflect new information faster than markets trading on the actual underlying commodities, meaning this information may provide an advantage to sophisticated investors.¹⁰⁰

A. *Old Markets, New Products*

The challenge in creating new markets focused on non-traditional financial products under CFTC jurisdiction is either: (1) overcoming the relative regulatory hurdles established by the CFTC, or (2) seeking a “special exemption from regulation” such as a no-action letter.¹⁰¹ Another option may involve seeking an existing exchange to list new financial products.¹⁰² Although derivatives received a large portion of the blame for the 2008 financial crisis due to their complexity, derivatives may present a meaningful opportunity to hedge against risk.¹⁰³ Provided that a product falls within the definition of “commodity”—and conversely does not fall within the list of excluded commodities—the regulation of the commodity or its derivatives falls within the CFTC's jurisdiction.¹⁰⁴ Off-exchange trading in excluded commodities typically may only occur between “eligible contract participants,” which are classically thought of as financial institutions.¹⁰⁵

97. Harris, *supra* note 95, at 1119.

98. Roberta Romano, *The Political Dynamics of Derivative Securities Regulation*, 14 YALE J. REG. 279, 382 (1997).

99. *Id.* at 383.

100. See Timothy E. Lynch, *Gambling by Another Name; The Challenge of Purely Speculative Derivatives*, 17 STAN. J. L. BUS. & FIN. 67, 81–82 (2011). See also Ryan Tracy & Scott Patterson, *Fast Traders Are Getting Data From SEC Seconds Early*, WALL ST. J., <http://www.wsj.com/articles/fast-traders-are-getting-data-from-seconds-early-1414539997> (last updated Oct. 29, 2014, 2:18 PM) [<https://perma.cc/WU6T-PNR9>].

101. Tom W. Bell, *Gambling for the Good, Trading for the Future: The Legality of Markets in Science Claims*, 5 CHAP. L. REV. 159, 169 (2002).

102. See *id.* at 169–70 (considering the creation of a new marketplace for science claim coupons by existing exchanges regulated by the CFTC).

103. See Jeremy A. Gogol, *The Case for Domestic Box Office Receipt Derivatives*, 14 CHAP. L. REV. 415, 415 (2011).

104. See David R. Overstreet et al., *Regulated Wagering on Events Markets: Analysis*, WORLD ONLINE GAMBLING L. REP. 9 (Aug. 2008) (on file with Authors).

105. The CFTC glossary notes that “[t]his classification permits these persons to engage in specific transactions (such as trading on a swap execution facility or entering into a bilateral swap trade) not directly available to non-eligible contract partici-

Additionally, the CFTC legislation contains a provision specifically governing event contracts, which prohibits listing transactions that the commission deems contrary to public interest or in violation of other enumerated provisions.¹⁰⁶ The broad definition of “commodity,” under the 1974 statute, includes “specific goods delineated in the statement (e.g. wheat, corn) and ‘all other goods and articles . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.’”¹⁰⁷ While the CFTC has previously acted to shut down Intrade and other markets operating in violation of the agency’s regulations, it has taken no public action against a DFS operator as of January 1, 2019.

B. *Illegal Exchange Activities*

The United States’ market regulation system has been one of shared regulatory authority between the federal government and the regulated industries themselves.¹⁰⁸ In the late 1800s, “bucket shops” began to emerge as a result of prestigious exchanges excluding less well-known brokerage houses.¹⁰⁹ Into the early 1900s, the power of bucket shops increased to the point that they dominated major exchanges, including the Chicago Board of Trade.¹¹⁰ Futures trading drew its legitimacy from the Supreme Court case *Board of Trade of Chicago v. Christie Grain & Stock Co.*¹¹¹ In *Board of Trade*, two commodity exchanges disputed the shared use of “continuous quotations of prices on sales of grain and provisions for future delivery”¹¹² In contract with several telegraph companies, the plaintiff collected information on pricing from the trading floor and then disseminated the quotes.¹¹³ The plaintiff’s provisioning of information to the telegraph companies was on the condition that the information would not be provided to bucket shops, in which case the information may be “used

pants, i.e., retail customers.” See *Eligible Contract Participant*, CFTC (2016), <https://cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm> (citing 7 U.S.C. § 1a(18)). Limited exceptions are made for off-exchange trading of foreign currencies provided that the party offering the transaction is a financial institution. See Mark D. Young et al., *Bitcoins and the Blockchain: The CFTC Takes Notice of Virtual Currencies*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP 2 (Jan. 2016), https://www.skadden.com/sites/default/files/publications/Bitcoins_and_the_Blockchain_The_CFTC_Takes_Notice_of_Virtual_Currencies.pdf [<https://perma.cc/WUV9-5NCQ>].

106. See 7 U.S.C. § 2(5)(c)(i)–(vi) (2018).

107. See Overstreet et al., *supra* note 104, at 9.

108. See Jake Keaveny, *In Defense of Market Self-Regulation—An Analysis of the History of Futures Regulation and the Trend Toward Demutualization*, 70 BROOK. L. REV. 1419, 1419 (2005).

109. *Id.* at 1423. Keaveny stated that bucket shops were titled as such because they “bucketed” their clients’ money, as opposed to depositing the money in banks. See *id.*

110. *Id.* at 1423–24.

111. *Bd. of Trade of Chi. v. Christie Grain & Stock Co.*, 198 U.S. 236 (1905).

112. *Id.* at 245.

113. *Id.* at 245–46.

as a basis for bets or illegal contracts.”¹¹⁴ The defendants, presumed by the Supreme Court to be bucket shop operators, defended against the suit by arguing that the plaintiff’s arguments were immaterial because no contractual relationship existed between the plaintiff and defendant.¹¹⁵ In giving legitimacy to the futures market system, Justice Holmes noted that the fact that a physical commodity does not actually change hands in a majority of transactions does not render the activity illegal.¹¹⁶

The use of the term “bucket shop” evolved to refer to stock selling operations that never execute buy or sell orders, instead the firm simply holds onto the money without ever investing it.¹¹⁷ In *Gatewood v. North Carolina*, the Supreme Court held that a North Carolina law that criminalized the operation of a business that traded futures was unconstitutional.¹¹⁸ Bucket shop laws are often categorized along with state gambling laws. In *Salomon Forex, Inc. v. Tauber*, the defendant argued that the more than \$25 million he owed to Salomon Forex was an unenforceable debt because “foreign currency futures [must] be traded exclusively on exchanges designated by the CFTC and that options be traded either on such exchanges or on securities exchanges designated by the [SEC].”¹¹⁹ Tauber was unsuccessful in his challenges to the Commodity Exchange Act (“CEA”) exemption for foreign currency and associated options and futures contracts being traded off-exchange.¹²⁰ Tauber was also unsuccessful in alleging that his transactions with Salomon Forex violated New York state bucket shop laws, with the Fourth Circuit noting that “[t]he New York statute does not ban legally enforceable trades settled by future transactions, but only sham transactions.”¹²¹ Similarly, in *Dunn v. CFTC*, the Supreme Court held that the CFTC had authority to regulate off-exchange options to buy or sell foreign currency.¹²²

In *CFTC v. American Board of Trade, Inc.*, the CFTC brought suit alleging that the defendant was engaged in transactions that required registration as an exchange.¹²³ The American Board of Trade argued that the CFTC only had jurisdiction over commodity futures options, as opposed to options on the commodities themselves.¹²⁴ The Second

114. *Id.* at 246.

115. *Id.*

116. *Id.* at 246–47.

117. See Julie M. Allen, *Kicking the Bucket Shop: The Model State Commodity Code as the Latest Weapon in the State Administrator’s Anti-Fraud Arsenal*, 42 WASH. & LEE L. REV. 889, 892 n.15 (1985).

118. *Gatewood v. North Carolina*, 203 U.S. 531, 536–37 (1906).

119. *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966, 973 (4th Cir. 1993).

120. *Id.* at 977.

121. *Id.* at 978.

122. *Dunn v. Commodity Futures Trading Comm’n*, 519 U.S. 465, 470–71 (1997).

123. *Commodity Futures Trading Comm’n v. Am. Bd. of Trade*, 803 F.2d 1242, 1244 (2d Cir. 1986).

124. *Id.* at 1244.

Circuit deemed the American Board of Trade's interpretation of the CEA to be without merit, in addition to a First Amendment claim that the court agreed was "conclusory, vague, and general."¹²⁵ Likewise in *CFTC v. Baragosh*, the CFTC filed a complaint alleging that the defendant had operated a "sham futures exchange."¹²⁶ Baragosh and others operated a company called Noble Wealth that promised trainees they would become futures traders with an investment of \$10,000.¹²⁷ Noble Wealth's managers created an elaborate ruse whereby traders believed they were trading with a licensed Hong Kong currency brokerage, when in fact the Court noted there was no evidence that Baragosh and the other Noble Wealth managers did anything with the traders' money.¹²⁸ The defendants were charged with misappropriating clients' money, "bucketing" customer orders, and offering to sell commodity futures off-exchange.¹²⁹ The Fourth Circuit held that it was Congress's intent to "extend the [CEA]'s regulatory protections to previously uncovered futures markets."¹³⁰ In addition, Congress also intended to ban futures trading outside of contracts markets, ban bucket shops, and require contract markets to adopt rules against fraud.

In *SEC v. Banc De Binary*, a Cypriot company without a license in the United States allowed investors to "bet[]" whether a particular stock would rise or fall by a specific date.¹³¹ The Court noted that unlike traditional stock options that allow an individual to purchase actual shares at a later date, so-called binary options contain no such right and "are in substance pure gambling bets."¹³² The district court observed that the SEC may assert jurisdiction over security options that are cash-settled versus delivery-settled.¹³³ The SEC's claims against Banc de Binary were supplemented by CFTC allegations that, from May 2011 to May 2013, Banc de Binary "solicited and permitted U.S. customers to buy and sell options betting on the prices of wheat, oil, platinum, sugar, coffee, corn, foreign currency pairs, and stock indices."¹³⁴

125. *Id.* at 1249, 1253 (citations omitted).

126. *Commodity Futures Trading Comm'n v. Baragosh*, 278 F.3d 319, 321 (4th Cir. 2002).

127. *Id.* at 322.

128. *Id.*

129. *Id.* at 323.

130. *Id.* at 328.

131. *Sec. & Exch. Comm'n v. Banc de Binary, Ltd.*, 964 F. Supp. 2d 1229, 1231 (D. Nev. 2013).

132. *Id.* at 1234.

133. *Id.* at 1235 (citing *Caiola v. Citibank N.A., N.Y.*, 295 F.3d 312, 326–27 (2d Cir. 2002)).

134. Press Release, Commodity Futures Trading Comm'n, *CFTC Charges "Prediction Market" Proprietor Banc de Binary With Violating CFTC's Off-Exchange Options Trading Ban and Operating as an Unregistered Futures Commission Merchant* (June 6, 2013), <http://www.cftc.gov/PressRoom/PressReleases/pr6602-13> [<https://perma.cc/XHV5-MQ6R>].

On September 29, 2005, the CFTC obtained a consent order against the Trade Exchange Network (“TEN”), which would later become the parent company of prediction market Intrade.¹³⁵ The CFTC alleged that between January 2003 and May 2005, TEN offered United States residents the ability to trade commodity options “not excepted or exempted” by the CFTC.¹³⁶ The consent order noted that TEN operated numerous websites on its platform from Ireland, including “www.Tradesports.com, www.Intrade.com, and TradebetX.com, as well as the now-deactivated website, www.Wallstreetsports.com.”¹³⁷ In the relevant period, the CFTC alleged that between one-third and four-tenths of TEN’s customers were based in the United States.¹³⁸ Without admitting to any specific allegations, TEN agreed to “cease and desist from violating the provisions of the Act and Commission Regulations that it has been found to have violated,” pay a fine of \$150,000, and comply with the order’s undertakings.¹³⁹

On November 26, 2012, the CFTC brought additional charges against Intrade and TEN, alleging that TEN breached the terms of the previous agreement and filed false statements with the CFTC while continuing to offer off-exchange options.¹⁴⁰ The CFTC filed this complaint in federal court in the District of Columbia.¹⁴¹ The CFTC complaint alleged that between 2007 and 2012, Intrade and TEN violated the 2005 consent order and the CEA as modified by the Dodd–Frank Act.¹⁴² The CFTC argued that despite the 2005 consent agreement, TEN, through Intrade, continued to offer and execute trades by United States-based customers on binary options, including future gold and oil prices and the United States unemployment rate.¹⁴³ In 2014, TEN and Intrade were ordered by the CFTC to produce a series of documents to the CFTC and to respond to interrogatories.¹⁴⁴ In August 2015, TEN was held in civil contempt by the District Court for

135. See *In re Matter of Trade Exchange Network*, CFTC No. 05-14, at *3–4 (Sept. 29, 2005).

136. *Id.* at *1.

137. *Id.*

138. *Id.* at *2.

139. *Id.* at *3.

140. See Press Release, Commodity Futures Trading Comm’n, *CFTC Charges Ireland-Based “Prediction Market” Proprietors Intrade and TEN With Violating the CFTC’s Off-Exchange Options Trading Ban and Filing False Forms With the CFTC* (Nov. 26, 2012), <http://www.cftc.gov/PressRoom/PressReleases/pr6423-12> [https://perma.cc/8DER-LHF6].

141. See Complaint at 2–3, 13–14, 16–17, *Commodity Futures Trading Comm’n v. Trade Exch. Network, Ltd.*, 1:12-CV-01902, at 2–3, 13–14, 16–17, (D.D.C. Nov. 26, 2012).

142. *Id.* at 2–3.

143. *Id.* at 3–4.

144. See *Commodity Futures Trading Comm’n v. Trade Exch. Network, Ltd.*, 61 F. Supp. 3d 1, 12 (D.D.C. 2014) (“TEN and Intrade must produce all documents responsive to the CFTC’s requests for production and also complete their responses to the CFTC’s interrogatories . . .”).

the District of Columbia for failing to comply with the 2014 order.¹⁴⁵ In November 2015, the district court awarded the CFTC attorneys' fees in connection with the 2014 order to comply.¹⁴⁶ The TEN matter has lingered for years, with many procedural matters preventing final disposition, including the company's liquidation in Ireland.¹⁴⁷

The CFTC also regulates through advisory correspondence. On December 19, 2011, Timothy G. McDermott—General Counsel and Chief Regulatory Officer of the North American Derivatives Exchange (“NADEX”)—sent a letter to CFTC Secretary David Stawick requesting to offer five products tied to United States Congressional and Presidential elections.¹⁴⁸ McDermott noted that NADEX is a fully registered and compliant organization that is licensed by the CFTC as a derivatives clearing organization.¹⁴⁹ NADEX has historically offered traditional binary derivative options and has occasionally offered event contracts including options on corporate mergers and housing prices.¹⁵⁰ McDermott argued that political event contracts are not prohibited by specific regulations adopted in the Dodd–Frank Act's section 745, which prohibits event contracts on terrorism, war, assassination, gaming, an activity that is unlawful under any state or federal law, or an event the Commission determines is contrary to the public interest.¹⁵¹ In response to McDermott's request, the CFTC held a ninety-day review of the proposal to allow the offering of event derivatives by an entity other than the Iowa Electronic Markets, which had been operating for over a decade pursuant to a CFTC no-action letter.

On February 16, 2012, McDermott wrote to Stawick for a second time, noting that McDermott believed that NADEX structured its po-

145. See *Commodity Futures Trading Comm'n v. Trade Exch. Network, Ltd.*, 117 F. Supp. 3d 22, 29 (D.D.C. 2015) (“[T]he Court holds defendants TEN and Intrade in civil contempt of Court for violating the Court's June 24, 2014 Order.”).

146. See *Commodity Futures Trading Comm'n v. Trade Exch. Network, Ltd.*, 159 F. Supp. 3d 5, 10 (D.D.C. 2015) (granting in part the plaintiff's motion for attorneys' fees).

147. See Plaintiff's Notice to the Court Regarding Status Update Provided by Defendants' Irish Liquidator and Statement by Liquidator That It Would Be Useful to Have a Ruling as Soon as Possible on Plaintiff's Request for a Civil Monetary Penalty at 1–2, *CFTC v. Trade Exch. Network, Ltd.*, No. 1:12-cv-01902-RCL (D.D.C. Apr. 16, 2018).

148. See Letter from Timothy G. McDermott, Gen. Counsel and Chief Regulatory Officer of NADEX to David Stawick, Sec'y of the Comm'n Commodity Futures Trading Comm'n (Dec. 19, 2011) (on file with authors).

149. *Id.* at 2.

150. *Id.*

151. See *id.* at 4. See also Ryan Rodenberg, *Prediction Markets Remain 'Promising,' But What About Sports?*, SPORTS HANDLE (Feb. 8, 2018, 8:30 AM), <https://sportshandle.com/prediction-markets-remain-promising-but-what-about-sports> [<https://perma.cc/6U37-K9V8>]. Section 745 of the Dodd–Frank Act presents several important questions regarding the validity of the provision in consideration of the First Amendment doctrines of void for vagueness and over breadth; however, those issues are beyond the scope of this Article.

litical derivatives to comply with the CEA and the Dodd–Frank Act.¹⁵² McDermott noted the importance of having a regulated marketplace where political derivatives may be offered.¹⁵³ In response to a series of questions submitted by the CFTC’s Stawick, McDermott pinpointed that the term “gaming” in Dodd–Frank may present problems if it applied to the act of trading contracts, as opposed to the underlying event.¹⁵⁴ McDermott argued that “gaming” refers to sporting events, such as the Super Bowl.¹⁵⁵ To support the contention that the proposed activities are not illegal under state or federal law, McDermott observed that the Unlawful Internet Gambling Enforcement Act (“UIGEA”) exempts transactions under the CEA from the definition of “bets” or “wagers.”¹⁵⁶ McDermott further noted that NADEX’s proposed offering was distinct from that of a bookmaker’s offering because, unlike a bookmaker who sets the price for participation, NADEX offers open markets where buyers and sellers meet and discover market prices at which they can trade.¹⁵⁷

On April 2, 2012, the CFTC issued an order prohibiting NADEX from offering political event derivative contracts.¹⁵⁸ The CFTC determined that “betting” on elections is forbidden under various state laws and that several state gambling definitions for “bet” and “wager” specifically include political events.¹⁵⁹ The CFTC further noted that

152. See Letter from Timothy McDermott to David Stawick, Re Industry Filing IF 12-003-90-day Review of NADEX’s Proposed Political Event Derivatives Contracts (Feb. 16, 2012) [hereinafter NADEX Comment Letter], <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexltr021612.pdf> [<https://perma.cc/V8S2-VTFB>].

153. *Id.* at 3.

154. *Id.* at 4.

155. *Id.* at 5.

156. *Id.* at 6. UIGEA similarly exempts certain fantasy games from the definition of “bets” or “wagers.” See John T. Holden, *The Unlawful Internet Gambling Enforcement Act and the Exemption for Fantasy Sports*, 28 J. LEGAL ASPECTS SPORT 97, 99–100 (2018).

157. NADEX Comment Letter, *supra* note 152, at 6.

158. See *In re Self-Certification by North American Derivatives Exchange, Inc., of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission, Order Prohibiting the Listing or Trading of Political Event Contracts*, CFTC (Apr. 2, 2012) [hereinafter CFTC Order on Political Events Contracts].

159. *Id.* at 2. The CFTC cited various state statutes in support of the contention that “betting” on elections violates state law including: 720 ILL. COMP. STAT. ANN. 5/28-1 (West 2011); N.M. STAT. ANN. § 44-5-10 (1978); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011); GA. CODE ANN. § 16-12-21(a)(2) (West 2011); MISS. CODE ANN. § 97-33-1 (West 2011); S.C. CODE ANN. § 16-19-90 (2011); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011); N.H. REV. STAT. ANN. § 287-D:1(VI) (2011); and WIS. STAT. ANN. § 945.01(1) (West 2011). See *id.* at 2, 2–3 & nn.1–2. By citing to various state laws in the course of ruling on the NADEX proposal, the CFTC demonstrated the expansive reach of its potential authority in the DFS context. Such breadth is particularly illustrative in Texas, where two DFS operators are conducting business despite a contrary memorandum from the Texas Attorney General about the legality of the operators’ fantasy contest under Texas state law. See Chris Grove, *FanDuel Returns to Texas Fantasy Sports Market After Two-Year Absence*, LEGAL SPORTS

increased uncertainty in political elections prevents sufficient hedging opportunities.¹⁶⁰ The CFTC denied the application because political event contracts constitute gaming under the CEA as amended by the Dodd–Frank Act and are contrary to the public interest.¹⁶¹ However, the CFTC did not elaborate on what constitutes gaming under the statute.¹⁶²

The CFTC has never specifically brought a public action against a sports derivatives dealer; however, the CFTC did not rule out the possibility it has jurisdiction over sports derivatives markets under its 2005 complaint against TEN and its various sports-based sub-components.¹⁶³ Federal courts have interpreted the CFTC’s jurisdiction broadly including authority over off-exchange currency trading and offenders located outside the United States availing themselves of American customers. Nevertheless, for determining whether the CFTC has jurisdiction over certain DFS contests—particularly matching up two participants—the relevant likely threshold question is whether certain DFS contests are prohibited event contracts similar to the proposed political offerings of NADEX. The absence of any decisions—excluding the NADEX and Intrade decisions—interpreting a substantially similar product to DFS head-to-head contests suggests that the most relevant case law relates to event futures contracts offered by NADEX and Intrade. Accordingly, Section IV examines several popular DFS sites in an effort to determine whether these sites are subject to the CFTC’s jurisdiction.

REP. (Aug. 28, 2018, 6:53 AM), <https://www.legalsportsreport.com/23349/fanduel-text-as-return/> [<https://perma.cc/LV4P-FBDH>].

160. *Id.* at 3.

161. *Id.* at 4. While the CFTC deemed the NADEX offering of political event contracts contrary to the public interest and gaming contrary to section 745 of the Dodd–Frank Act, in 2014 the CFTC granted a no-action letter to New Zealand’s Victoria University. See Vincent McGonagle, Director, Div. of Mkt. Oversight, CFTC No-Action Letter, CFTCLTR No. 14-130 (Oct. 29, 2014) [hereinafter CFTC No-Action Letter to Quigley], available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@rllettergeneral/documents/letter/14-130.pdf> [<https://perma.cc/VEW7-V78E>]. The CFTC’s no-action letter to Victoria University facilitated the emergence of PredictIt, a Washington, DC-based prediction market. See Ryan Rodenberg, *How to Speculate—With Real Money—On the Supreme Court Sports Betting Case*, SPORTS HANDLE (Feb. 7, 2018, 9:45 AM), <https://sportshandle.com/supreme-court-sports-betting-speculate-real-money> [<https://perma.cc/V3U9-XAJL>]. See also Ryan Rodenberg, *Why Sports Prediction Markets Are Like Onions and Box Office Movie Receipts*, SPORTS HANDLE (Feb. 9, 2018, 8:45 AM), <https://sportshandle.com/sports-prediction-markets-onions-box-office-receipts> [<https://perma.cc/VF8F-PT7W>].

162. See Commodity Futures Trading Comm’n Order on Political Events Contracts, *supra* note 158, at 4.

163. See *In re Matter of Trade Exchange Network*, CFTC No. 05-14, at *3–4 (Sept. 29, 2005).

IV. DAILY FANTASY SPORTS WEBSITES AND PROHIBITED ACTIVITIES

DFS operators offer several types of DFS contests, including GPPs, head-to-head contests, and 50/50s.¹⁶⁴ Among the varieties, head-to-head contests offered by nearly all DFS providers are the most similar to an exchange transaction.¹⁶⁵ While many companies do not provide a complete description of how their head-to-head contests operate, the basic mechanics of the games can be deduced from the “Frequently Asked Questions” section of the DraftKings website.¹⁶⁶ In head-to-head contests, an individual can either propose a contest or accept to participate in a contest.¹⁶⁷ In many unfilled/unmatched head-to-head contests,¹⁶⁸ an individual may cancel the offer, or the contest will automatically terminate if not filled by a designated time; however, once a contest is filled, the offeror must execute the agreement by participating in the contest.¹⁶⁹ Some sites also allow offerors to limit the number of times an offeree may accept an individual contestant’s open offer.¹⁷⁰ In a manner similar to an exchange platform, the DFS site facilitates contests that may represent a sports binary derivative product whereby the offeree’s acceptance acts as a short position against the offeror’s offer that the offeror will receive a greater number of fantasy contest points.¹⁷¹

Some websites appear to offer a service whereby the site provider matches two users seeking to participate in a head-to-head fantasy contest. DraftKings noted that its employees are forbidden from participating on the site, and employees of other sites using inside information are not allowed to utilize that information on DraftKings’s site; however, there is no specific mention of non-employee insiders using proprietary information to compete on the site.¹⁷² While there are a variety of contests for users, those with the most evident connec-

164. See, e.g., *Frequently Asked Questions*, DRAFTKINGS, <https://www.draftkings.com/help/faq> (last visited July 10, 2018) [<https://perma.cc/SEN6-EWFD>].

165. *Id.*

166. *Id.*

167. *Id.* In a case involving a website titled “Betcha.com,” the Washington State Gambling Commission required the operator of a peer-to-peer betting site to shut down for violating state gambling laws. See Ryan Rodenberg, *eBay Meets Facebook in Las Vegas: The Fascinating Story of Betcha.com*, ESPN (Aug. 25, 2015), http://www.espn.go.com/chalk/story/_id/13506773/betting-bookmaking-curious-case-betcha-com-chalk [<https://perma.cc/WX3H-R83H>].

168. Unfilled contests are those which do not have two competitors.

169. *Frequently Asked Questions*, *supra* note 164.

170. *Id.*

171. A short position would be taken because otherwise an individual would essentially end up wagering against their own sports derivative line-up.

172. See *Frequently Asked Questions*, *supra* note 164 (expand “Policy on Employee Participation”). Employee participation has proven thorny for DFS companies, as there is a challenge in having passionate employees and maintaining both the integrity of the underlying fantasy contests and, perhaps more important, the appearance of integrity. See Holden et al., *supra* note 13, at 16–17.

tion to securities laws are the head-to-head contests that mimic peer-to-peer stock markets and betting exchanges.¹⁷³

Some sites enable players to craft their own contests that other users can join.¹⁷⁴ FanDuel, for instance, explicitly stated that head-to-head contests will not “take place without two willing competitors.”¹⁷⁵ Additionally, FanDuel noted that once two head-to-head contestants are matched, the contestants cannot cancel the agreement.¹⁷⁶ In addition to restricting the ability of users to cancel a matched head-to-head contract, some DFS sites explicitly note that the company reserves the right to cancel contests at the company’s discretion.¹⁷⁷ Other DFS sites use head-to-head contests that are entirely user-initiated, in much the same way that an individual initiates an offer for a sale of shares on a personal brokerage account, which then connects a buyer with the seller’s offer.¹⁷⁸ FanDuel’s website noted that head-to-head contests are always against other users and that if an opponent does not get matched by closing time, the FanDuel system will attempt to match competitors.¹⁷⁹ The FanDuel system that links two customers is quite similar to an exchange bid-matching system whereby two willing users are matched at a set contest price.

FanDuel, for example, appears to explicitly attempt to match up unfilled head-to-head contests.¹⁸⁰ Some DFS sites allow users to view offers to accept a match-up, while a fewer number of sites allow users to propose the terms of a transaction—similar to an individual seeking to unload a financial product on a market. Given the similarities to several features of regulated financial markets and investment transactions, what follows is an analysis of the head-to-head contests offered and an analysis of whether any of the fantasy contests bear sufficient similarity to the activities that have resulted in enforcement actions. The analysis will conclude that DFS sites may need to be con-

173. In addition, there is the possibility that multi-participant tournaments may invoke investment and securities laws if it were determined that the participants were utilizing a non-participant’s money and acting as an investment advisor; however, there is presently insufficient evidence that this practice is taking place. Though beyond the scope of this Article, large contests such as GPPs and 50/50s may violate some state laws against gambling pools.

174. *Id.*

175. *See Rules*, FANDUEL, <https://www.fanduel.com/rules> (expand “Unfilled Contests”) (last visited Dec. 30, 2018) [<https://perma.cc/UP8H-63YR>].

176. *Id.* (expand “Contest Cancellation”).

177. FanDuel noted that contest cancellations would be a rare event typically reserved for widespread concerns about contest integrity. *See id.*

178. *See* Matt Hevia, *FanDuel Tips: Contest Type Explanations*, FANDUEL (Aug. 29, 2014), <http://www.fanduel.com/insider/2014/08/29/game-explanations> [<https://perma.cc/PTY6-UQX8>].

179. *Id.*

180. *See Rules*, *supra* note 175.

cerned with federal agencies beyond those who have already commenced investigations.¹⁸¹

A. *Do DFS Sites Fall Under the Purview of the CFTC?*

The threshold question in determining whether any of DFS sites may be subject to the jurisdiction of a regulator is whether DFS contests fall within the CFTC's regulatory scope. The base level analysis examines whether a head-to-head contest on a DFS site constitutes an event contract. Overstreet et al. observed that the CFTC views event contracts as "possessing the characteristics of both options and futures."¹⁸² Commonly structured event contracts are binary options where either an event takes place and the contract pays, or the event does not take place and the speculator receives nothing.¹⁸³ Futures-based event contracts are those that allow users to receive a multiplier beyond the initial outlay.¹⁸⁴

The event contract must fall within the definition of "commodity" or "excluded commodity."¹⁸⁵ An excluded commodity is particularly relevant to event contracts and "is defined to be, as relevant here, 'an occurrence, or contingency associated with a financial or economic consequence that is not within the control of the parties to the relevant transaction.'"¹⁸⁶ No court has adopted the theory that event contracts are excluded commodities.¹⁸⁷

The Dodd–Frank Act emerged as a response to the economic volatility of its preceding years.¹⁸⁸ The invention of swaps to provide a financial instrument that can meet the exact specifications of a particular party created an evolution in the commodities market, which was once characterized by the template structure of commodity futures where only the price fluctuated.¹⁸⁹ The Dodd–Frank Act is "849 pages, 16 titles, and 225 new rules across 11 agencies."¹⁹⁰ One of the weaknesses of the Dodd–Frank Act was that it failed to sufficiently provide clarity and regulatory oversight for the "shadow banking sys-

181. During a quasi-academic conference, a lawyer representing several DraftKings managers mentioned a number of federal-level probes of the DFS industry. See Staff, *Here's Where the Federal Investigations Into Daily Fantasy Sports Might Be Focused*, LEGAL SPORTS REP. (Mar. 18, 2016, 4:47 PM), <http://www.legalsportsreport.com/9053/dfs-federal-issues> [<https://perma.cc/9VD9-ZYFQ>].

182. See Overstreet et al., *supra* note 104, at 9.

183. *Id.*

184. *Id.*

185. *Id.* at 9–10.

186. *Id.*

187. *Id.* at 10.

188. See Chelsea J. Bacher, *Regulating the Swaps Market After the Dodd–Frank Act: In an Economic Crisis, Is Regulation Always the Answer?*, 5 CHARLESTON L. REV. 545, 546 (2010).

189. *Id.* at 550–51.

190. See Matthew Richardson, *Regulating Wall Street: The Dodd–Frank Act*, 3Q/2012 ECON. PERSP. 85, 85 (2012).

tem” and “regulatory arbitrage.”¹⁹¹ While it is unclear as to whether event futures are covered, the Dodd–Frank Act did provide some clarity to the issue.¹⁹²

Section 745 of the Dodd–Frank Act modified the CEA and includes section 5(c), which provides as follows:

(C) SPECIAL RULE FOR REVIEW AND APPROVAL OF EVENT

CONTRACTS AND SWAPS CONTRACTS.—

(i) EVENT CONTRACTS.—In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i)), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.¹⁹³

In response to the changes implemented by the Dodd–Frank Act, the CFTC issued a question and answer sheet (“Q & A Sheet”) regarding the rule implementation.¹⁹⁴ The Q & A Sheet noted that the rules adopted by the CFTC “prohibit the listing or clearing of event contracts based upon certain excluded commodities.”¹⁹⁵ The excluded commodities include: “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation to be contrary to the public interest.”¹⁹⁶ In the Q & A Sheet, the CFTC noted that the list of prohibited contract subjects is not exhaustive and is subject to future modification.¹⁹⁷ To date, the only known interpretation of section 745 occurred in the CFTC’s or-

191. *Id.* at 93.

192. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 745(c)(5)(C)(i)–(iii), 124 Stat. 1376, 1736–37 (codified as amended at 7 U.S.C. 7a-2(c)(5)(C)(i)–(iii) (2018)).

193. *Id.* § 745(c)(5)(c)(i).

194. *See* CFTC, OFFICE OF PUB. AFFAIRS, Q & A – PART 40 FINAL RULEMAKING 1, http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/p40_qa_final.pdf [<https://perma.cc/3Y8T-GTY7>] [hereinafter CFTC Q & A SHEET].

195. *Id.*

196. *See* Dodd–Frank Act § 745(c)(5)(C)(i)(I)–(IV), 124 Stat. at 1737.

197. *See* CFTC Q & A SHEET, *supra* note 194, at 3 (answering “[n]o” to the question “Are all event contracts prohibited under the final regulations?”).

der denying NADEX the ability to offer political event contracts.¹⁹⁸ In the NADEX's response letter, NADEX referenced that the "gaming" exception prohibits Super Bowl event contracts.¹⁹⁹ NADEX cited statements by Senator Blanche Lincoln, who posited that "an 'event contract' around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament" lacks a "commercial purpose."²⁰⁰ The CFTC has never issued an official interpretation of the meaning of "gaming" in the list of excluded commodities. While the CFTC denied NADEX's proposed political event offering, the CFTC issued a no-action letter in 2014 to Victoria University to offer political futures, raising the possibility that the CFTC has reconsidered its original position.²⁰¹

While the status of any current investigations by securities or investment regulators is unknown, some DFS companies may ultimately have to answer questions in the future regarding the nature of their products and whether they illegally facilitate off-exchange trading in excluded event contracts.²⁰² If DFS companies offer prohibited event contracts—because their sport derivative contracts fall within the definition of "excluded commodities"—then, these companies may be subject to either civil or criminal penalties.

Most DFS companies offer GPPs, 50/50s, and head-to-head contests, though many have their own specific, unique offerings. GPP contests and 50/50 contests are likely the most popular, perhaps because they offer the most money.²⁰³ These contests do not resemble products that the CFTC has previously taken action against. Indeed, such contests appear to operate in a manner more similar to a lottery or a sports pool.²⁰⁴ The head-to-head contests offered by DFS compa-

198. See CFTC Order on Political Events Contracts, *supra* note 158, at 4.

199. NADEX Comment Letter, *supra* note 152, at 5.

200. 156 CONG. REC. at S5907 (daily ed. July 15, 2010) (statement of Sen. Lincoln). Senator Lincoln further clarified that event contracts around sporting events "would be used solely for gambling" and argued that the CFTC "needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling." *Id.* at S5906–07.

201. See CFTC No-Action Letter to Quigley, *supra* note 161.

202. See 17 C.F.R. § 40.11 (2018); see also 7 U.S.C. §§ 6c, 7 (2018).

203. See Ehrman, *supra* note 9, at 86.

204. A sports pool is a type of sports gambling where "all money bet on the result of a particular event by a number of people is awarded to one or more winners according to conditions established in advance (taxes, operating expenses, and other charges may be deducted from the total pool before prizes are awarded)." See *Pool*, ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/topic/pool-gambling> (last visited Dec. 30, 2018) [<https://perma.cc/M3KY-7JD8>]. In 1991, Florida Attorney General Robert Butterworth opined that participation in certain fantasy sports leagues where a fee is paid to enter is a form of illegal gambling. See Robert Butterworth, *Advisory Legal Opinion — AGO 91-03*, FLA. OFF. ATT'Y GEN. (Jan. 8, 1991), <http://www.myfloridalegal.com/ago.nsf/Opinions/9ADEF3B402960199852562A6006FB71E> [<https://perma.cc/3HMR-WFZL>]. The Nevada Office of the Attorney General concluded that DFS contests constitute sports pools. See Memorandum from J. Brin Gibson, Bureau Chief of Gaming & Gov't Affairs & Ketan D. Bhirud, Head of Complex

nies all allow customers to choose to enter a contest; however, several DFS operators attempt to match individuals who are not matched by a designated time.²⁰⁵ The basic head-to-head contest involves a customer selecting a contest and choosing a line-up of real-world athletes, and the customer remains blind to other potential entrants line-ups. The second customer (or offeree) enters into the same contest with the assertion that his or her chosen line-up will perform better than the first customer's—the offeror's—line-up. The margin of victory between the two contestants is immaterial.²⁰⁶ The payment of the head-to-head contest “contract” between the two only depends on whether one contestant's line-up outperforms the other's. Each head-to-head contest acts as a yes (or no) wager that one fantasy roster line-up will defeat the other.²⁰⁷ DFS contests likely do not offer a bona fide commercial purpose that would distinguish such contests from the examples mentioned by Senator Lincoln in 2010.²⁰⁸

A bet on a sporting event is possibly within the definition of “gaming” under the Dodd–Frank Act.²⁰⁹ The challenge of bringing a civil or criminal action against a DFS company is that the CFTC has not yet taken a public enforcement action against an operator who primarily deals in sports derivatives.²¹⁰ While each site's head-to-head con-

Litig. to A.G. Burnett, Chairman, Nev. Gaming Control Bd., Terry Johnson, Member, Nev. Gaming Control Bd. & Shawn Reid, Member, Nev. Gaming Control Bd. (Oct. 16, 2015), <http://www.legalsportsreport.com/wp-content/uploads/2015/10/Nevada-AG-DFS.pdf> [<https://perma.cc/644N-RW8U>]. Indeed, FanDuel described their business model as part of its filings in litigation in New York stating: “In fantasy sports . . . , participants pay an entry fee to participate in a contest, and the entry fees generate the fund from which the successful contestants win prizes.” Brief for Defendant-Appellant at 20, *New York v. FanDuel, Inc.*, No. 453056/15 (N.Y. App. Div. Feb. 22, 2016) [hereinafter *FanDuel Brief*].

205. See *Rules*, *supra* note 175 (expand “Unfilled Contests”).

206. FanDuel and DraftKings have each argued in court documents that the fantasy contest is a separate event vis-à-vis the actual athletic event from which relevant player-level statistics are derived. FanDuel's attorney's posited “fantasy sports competitors are active participants in a parallel fantasy contest of their own, which exists separate and apart from any underlying athletic event and does not turn on the outcome of any such event, or on the outcome of any other single real-world occurrence.” FanDuel Brief, *supra* note 204, at 12. FanDuel's arguments show how fantasy sports are similar to how other certain financial products, which derive from an underlying security or asset—like Collateralized Debt Obligations—are unique. See Memorandum of FanDuel Inc. in Opposition to Plaintiff's Motion for a Preliminary Injunction at 37–38, *New York v. FanDuel, Inc.*, No. 453056/2015 (N.Y. App. Div. Nov. 23, 2015).

207. It may be possible in some DFS iterations to intentionally select a losing line-up for purposes of money laundering.

208. See 156 CONG. REC. S5906–07 (daily ed. July 15, 2010) (statement of Sen. Lincoln).

209. This does not preclude any company or individual from self-certifying and seeking a no-action letter from the CFTC if they believe that a DFS exchange may present a value to society. See 7 U.S.C. § 7a-2 (2018); see also CFTC Order on Political Events Contracts, *supra* note 158, at 2 nn.1–2.

210. The CFTC did mention TradeSports in its complaint; however, there was no specific mention of TradeSports specifically offending CFTC regulations. See Com-

tests are slightly different, companies that attempt to match unfilled head-to-head match-ups may present an additional aggravating factor in considering whether the CFTC could ever move forward with an enforcement action.²¹¹ While other companies may argue that their sites allow users to compete against each other, sites that use automated matching are more closely related to the electronic clearing mechanisms that match buyers and sellers of financial products at a matched price.²¹² Although nearly all DFS sites offer head-to-head contests that—by virtue of the Dodd–Frank Act, interpretations of the CFTC’s earlier orders, and judicial decisions—may fall within the jurisdiction of the CFTC, there has been no indication that the CFTC is currently investigating any DFS companies. Nevertheless, the CFTC likely could bring charges against certain DFS operators arguing that their head-to-head contests represent event contracts.

B. *What If the CFTC Asserts Jurisdiction?*

On October 5, 2015, the *New York Times* observed “[a] major scandal is erupting in the multibillion-dollar industry of fantasy sports.”²¹³ The major scandal referred to allegations that an employee at DraftKings, with access to valuable non-public information, participated in contests on FanDuel and was successful.²¹⁴ A DraftKings spokesman acknowledged that both DraftKings and FanDuel employees had won “big jackpots” on rival sites, but both sites argued that their employees were forbidden from participating on their respective employer’s website.²¹⁵ While the major DFS companies denied that the employees used “insider information” to be successful on competitors’ websites, such assertions were met with skepticism and arguably resulted in unwanted attention on the industry that had asserted itself as being fundamentally different than sports gambling.²¹⁶

The events that precipitated the focus on employee access began on September 27, 2015, when Ethan Haskell, of DraftKings, posted information regarding how frequently participants selected certain NFL

plaint for Permanent Injunction, Civil Monetary Penalty, & Other Equitable Relief at 2–3, 6, 13–14, 16–17, *Commodity Futures Trading Comm’n v. Trade Exch. Network, Ltd.*, 1:12-CV-01902 (D.D.C. Nov. 26, 2012).

211. See *Rules*, *supra* note 175 (expand “Unfilled Contests”).

212. Electronic clearing systems enable the transfer of money and securities from buyer to seller. See Tania Kishore Jaleel, *What Is Electronic Clearing Service (ECS)?*, *BUS. STANDARD* (Jan. 20, 2013, 10:58 PM), http://www.business-standard.com/article/pf/what-is-electronic-clearing-service-ecs-111070800019_1.html [<https://perma.cc/JP8J-3E936tg>].

213. See Joe Drape & Jacqueline Williams, *Scandal Erupts in Unregulated World of Fantasy Sports*, *N.Y. TIMES* (Oct. 5, 2015), <http://www.nytimes.com/2015/10/06/sports/fanduel-draftkings-fantasy-employees-bet-rivals.html> [<https://perma.cc/MXB8-ADV5>].

214. *Id.*

215. *Id.*

216. *Id.*

players on the DraftKings website.²¹⁷ Such information provided the holder with a distinct advantage over competitors, as knowing who the most commonly held players were would provide the user the ability to incrementally distinguish his or her fantasy line-up to finish ahead of others.²¹⁸ While Haskell denied using his access at DraftKings to procure ownership data for personal use, he won a prize of \$350,000 on FanDuel in a single contest.²¹⁹ The allegations against Haskell were not an isolated incident in the DFS industry. In addition to Haskell, a FanDuel employee—Matt Boccio—was also an avid DFS player.²²⁰ Indeed, Boccio was responsible for setting the values assigned to players on FanDuel, and Rotogrinders ranked him amongst the top fifty DFS contestants in the world.²²¹ Additionally, some DraftKings’ employees engaged in the practice of “bumhunting” in which they repeatedly targeted “suboptimal player[s]” in head-to-head matchups.²²² DraftKings employee Jon Aguilar also revealed to an invitee at a DraftKings event that he had access to player usage data, which could be used to differentiate a line-up to increase the odds of not having to split a prize.²²³

The release of information regarding the win rates of highly successful players followed the DFS insider information scandals. During a time period in 2015, the top eleven DFS players accounted for 17% of studied entry fees and had an average positive return on investment of +7%, compared to the bottom 80% of players who had a negative return on investment of -51%.²²⁴ The “shark versus minnow” issue represented a challenge for DFS companies to overcome, especially when it appeared that a number of the successful customers worked for the DFS operators themselves and could access proprietary information that may provide an important advantage over competitors.²²⁵ If DFS sites are within the scope of the CFTC’s jurisdiction, it follows that DFS companies may have an additional concern regarding the use of insider information and potential charges for implicated employees.²²⁶

217. See John Culhane, *The DraftKings Crash*, SLATE (Oct. 13, 2015, 4:47 PM), http://www.slate.com/articles/sports/sports_nut/2015/10/the_insider_trading_scandals_could_bring_down_draftkings_and_fanduel.html [<https://perma.cc/GMY3-GX2S>].

218. *Id.*

219. *Id.*

220. See Drape & Williams, *supra* note 213.

221. Joe Drape & Jacqueline Williams, *In Fantasy Sports, Signs of Insiders’ Edge*, N.Y. TIMES (Oct. 11, 2015), https://www.nytimes.com/2015/10/12/sports/fantasy-sports-draftkings-fanduel-insiders-edge-football.html?_r=0 [<https://perma.cc/Z85T-FCU7>].

222. *Id.*

223. *Id.*

224. See Miller & Singer, *supra* note 74.

225. *Id.*

226. See Curt Woodward, *US Fantasy Sports Inquiries Could Drag on, Lawyer Says*, BOS. GLOBE (Apr. 8, 2016), <http://www.bostonglobe.com/business/2016/04/07/federal->

On December 31, 2015, the international law firm of Sidley Austin released a client advisory update titled: *CFTC Asserts Its Broader Fraud Jurisdiction and Steps into the World of Insider Trading*.²²⁷ The update noted that the CFTC brought a regulatory filing against Arya Motazed, a commodities trader who fraudulently executed trades on his personal accounts while utilizing company accounts to achieve favorable prices—a practice known as front-running.²²⁸ The CFTC obtained an order against Motazed which found him responsible for several violations of the CEA, including *Section 4b: Fraud*, which states:

Section 4b(a) makes it unlawful for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce or for future delivery that is made, on or subject to the rules of a designated contract market, for or on behalf of any other person: (A) to cheat or defraud or attempt to cheat or defraud such other person; or (C) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act or agency performed with respect to such order or contract for such person.²²⁹

Fraud charges related to front-running are common.²³⁰ However, the use of section 6(c)(1)—which was added under the Dodd–Frank Act and utilized against Motazed—was a sign that the CFTC was intent on attacking both fraud and manipulation of regulated markets.²³¹ Section 6(c)(1) states:

(1) Prohibition against manipulation

It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after July 21, 2010, provided no rule or regulation promulgated by the Commission shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the

fantasy-sports-probes-could-drag-out-for-months-lawyer-says/J9HZ1FSZzspUCcIcl-qUuRL/story.html [https://perma.cc/E79L-2JT6].

227. See Geoffrey Aronow & Michael Sackheim, *CFTC Asserts Its Broader Fraud Jurisdiction and Steps Into the World of Insider Trading*, SIDLEY AUSTIN LLP (Dec. 31, 2015), <http://www.sidley.com/news/12-31-2015-investment-funds-update> [https://perma.cc/LU45-ZWP2].

228. *Id.*

229. See *In re Arya Motazed*, CFTC No. 16-02, 2015 WL 7880066 at *3 (Dec. 2, 2015).

230. Aronow & Sackheim, *supra* note 227.

231. *Id.*

other person in or in connection with the transaction not misleading in any material respect.²³²

The *Motazedi* case was not a traditional case of market manipulation.²³³ In a traditional case, the action asserts a manipulation claim and the agency receives an order deeming such. The *Motazedi* case is meaningful as to explaining the scope of what constitutes the CFTC's view of manipulation.²³⁴ The CFTC sent a strong message.²³⁵ Contrary to the perception that insider trading in all markets has always been illegal, insider trading was previously "entirely legal in the commodities and futures markets," and some suggest there may still be leeway in commodities and futures markets.²³⁶ The 10(b)(5) protections in the Securities Act were designed to protect the "retail investor," but historically only commodities experts ventured into the commodities and futures markets.²³⁷ This previous perception is almost certainly false, as at least 12.5% of the participants in the commodities market would be classified as retail investors.²³⁸ Even with the advent of the Dodd–Frank Act, there remains a gap in the power to regulate insider trading in securities and commodities markets.²³⁹

The purpose of regulating insider trading is to protect against those who breach their duties of "trust and confidence."²⁴⁰ The question of whether DFS employee insiders breached a duty of trust or confidence is a question for a jury to answer. There is a possibility that the CFTC could assert jurisdiction over the DFS head-to-head contests as event futures contracts. Beyond the CFTC, federal prosecutors possess broad power to act against fraud: "The mail and wire fraud statutes enable the federal government to prosecute virtually anyone who uses either of these ubiquitous means in furtherance of a fraudulent scheme."²⁴¹ As such, wire and mail fraud statutes may incorporate a broader level of activity than insider trading statutes.²⁴² The terms

232. *Id.* at 6.

233. *See id.* at 3.

234. *Id.*

235. *See* Craig R. Enochs et al., *CFTC Enforces Insider Trading Rules and Aggressively Pursues Its New Enforcement Authority Under the Dodd–Frank Act*, REED SMITH (Dec. 22, 2015), <http://www.reedsmith.com/CFTC-Enforces-Insider-Trading-Rules-and-Aggressively-Pursues-Its-New-Enforcement-Authority-under-the-Dodd-Frank-Act-12-22-2015> [https://perma.cc/Z9MS-UXC7].

236. Andrew Verstein, *Insider Trading in Commodities Markets*, 102 VA. L. REV. 447, 448 (2016).

237. *See id.* at 449.

238. *Id.* at 482.

239. *Id.* at 499–500.

240. *Id.* at 487.

241. Susan Getzendanner, *Judicial "Pruning" of "Garden Variety Fraud" Civil RICO Cases Does Not Work: It's Time for Congress to Act*, 43 VAND. L. REV. 673, 680 (1990).

242. William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability for Stock Market Insider Trading and Tipping*, 70 U. MIAMI L. REV. 220, 222 (2015). Indeed, internal documents from FanDuel revealed in state-

wire and mail incorporate a broad range of activities, including the use of the internet.²⁴³ Thus, the pursuit of federal charges against DFS companies and their employees may provide a less novel avenue than risking an adverse ruling by attempting to litigate a case of first impression as to whether DFS contests fall within the scope of the CFTC's jurisdiction.²⁴⁴ It is likely that head-to-head DFS contests could be considered prohibited event contracts by virtue of the Dodd–Frank Act's special rules for event contracts; however, given the lack of judicial interpretation of section 745 of the Dodd–Frank Act and the high profile nature of the DFS industry, federal agencies may elect prosecution under more established statutes.

level litigation showed that FanDuel issued a memo to employees and required a signature as acknowledgement that employees should not win excessive amounts of money on rival sites, so as to avoid the impression of improprieties. *See* Complaint at 19–20, *People v. FanDuel, Inc.*, No. 435056/15, 2015 WL 8490461 (N.Y. Sup. Ct. Nov. 17, 2015); *see also* Kevin Draper, *FanDuel Told Employees Not to Win Too Much Money on DraftKings or People Would Get Suspicious*, DEADSPIN (Nov. 20, 2015, 3:58 PM), <http://www.deadspin.com/fanduel-told-employees-not-to-win-too-much-money-on-dra-1743814536> [<https://perma.cc/78AU-SUP5>].

243. Wang, *supra* note 242, at 226.

244. “Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation occurs in relation to, or involving any benefit authorized, transported, transmitted, transferred, disbursed, or paid in connection with, a presidentially declared major disaster or emergency (as those terms are defined in section 102 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5122 (2018))), or affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.” 18 U.S.C. § 1343 (2018). Mail fraud is codified at 18 U.S.C. § 1341 and states: “Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation occurs in relation to, or involving any benefit authorized, transported, transmitted, transferred, disbursed, or paid in connection with, a presidentially declared major disaster or emergency (as those terms are defined in section 102 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5122)), or affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.” 18 U.S.C. § 1341 (2018).

V. CONCLUSION

While head-to-head DFS contests could plausibly be construed as unregistered exchanges, the more pressing issue is likely whether DFS head-to-head contests are prohibited event contracts and constitute gaming under CFTC regulations derived from the Dodd–Frank Act. The CFTC also has broad jurisdiction to prohibit the listing of an event contract as contrary to the public interest, which the CFTC noted in its NADEX order.²⁴⁵ The way in which many DFS sites operate head-to-head contests—effectively as binary sport derivative contracts—may render those contests within the scope of prohibited event contracts under the CFTC’s jurisdiction. Thus, DFS sites would need an exemption to avoid non-compliance with the provisions listed in the Dodd–Frank Act. The broad jurisdiction granted to the CFTC, coupled with the agency’s prior enforcement actions, suggests that the CFTC could pursue regulatory oversight in the context of DFS head-to-head contests.

Applying CFTC regulations to DFS head-to-head contests may represent an additional challenge for DFS operators, many of whom underestimated the potential sources of liability facing the industry.²⁴⁶ The CFTC’s jurisdiction over event contracts could potentially set up the agency to one day regulate the DFS market or even a sports gambling market. Specifically, it appears likely that the CFTC could regulate certain DFS contests—especially the head-to-head variety—as a type of financial product.

245. See CFTC Order on Political Events Contracts, *supra* note 158, at 2–4.

246. The Unlawful Internet Gambling Enforcement Act was widely cited by many within the industry as evidence that the games were lawful. This position is likely a hyperbolic interpretation of the importance of the statute given that the statute’s rule of construction states that it does not modify any existing state or federal law. 31 U.S.C. § 5361(b) (2018). See also Holden, *supra* note 156, at 108.

