DERBY WARS RULING A LEGAL BLOW ACROSS DFS INDUSTRY

A recent California court ruling that went against a horse racing fantasy sports provider could prove to be a blow for the entire DFS market in the US, writes leading California gaming attorney **David M. Fried**.

When a United States District Court in Los Angeles ruled against Horse Racing Labs last month some within the DFS industry appeared unconcerned, expressing a view that the ruling was relevant only to the horse racing industry.

But while the issue may have been whether the 'Derby Wars' daily contest for picking the winners of several horse races was prohibited under the federal Interstate Horseracing Act (IHA), the effect of the decision could reverberate far beyond horse racing.

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In *Los Angeles Turf Club et al. v. Horse Racing Labs, LLC, CV 15-09332, US. District Court, Central Dist. of California, May 15, 2017*, the court held in a preliminary ruling that the contest entry fees were in fact wagers and therefore in contravention of the IHA.

But Derby Wars contests are structured similarly to the daily fantasy sports (DFS) contests operated by companies such as FanDuel and DraftKings. In Derby Wars, each player pays a fixed entry fee and has to pick winning horses in a series of races. With the DFS companies, contest points are based on the statistical performance of individual athletes across multiple teams. In both cases, the prize is often the sum of the fixed entry fees from participants, less a percentage to the operator.

For example, in a head-to-head contest each person might pay an entry fee of $50, with a prize of $90 to the winner and $10 to the operator. In effect, the participants are staking the entry fee on their ability to better predict the outcomes than some or all of the other participants, with the prize paid from the entry fees, although some contests also may have guaranteed prize pools as an inducement.

Although the plaintiff and respondent argued over whether or not Derby Wars was operating a pari-mutuel content, this point proved irrelevant — the court held that under IHA the determinative question was whether the entry fees were wagers, regardless of whether the contests were pari-mutuel. The court also found that whether skill predominates over chance was irrelevant under IHA.

In fact, the court analogized the entry fees to wagers in a common pot similar to poker games, that is, "an agreement between two or more that a sum of money or some valuable thing... shall become the property of one or some of them on the happening in the future of an event at the present uncertain; and the stake is the money or thing thus put upon the chance." The court cited the case of *Bell Gardens v. Department of Justice, (1995) 36 Cal.App.4th 717, 747*, a case that considered whether a jackpot poker game constituted an illegal lottery.

Therefore the court's decision that contestants' entry fees were wagers made into a pot from which Derby Wars pays the prize(s) has ramifications for DFS operators across the board, not just those in the horse racing vertical. The decision could prove costly for those companies which operate similar contests in other sports.

Even if fantasy contests are exempted from the UIGEA – a federal law regarding gambling transactions – UIGEA does not

authorize fantasy contests or override other federal or state laws that restrict wagering.

Some larger states – important economically for fantasy sports companies – have gambling laws that similarly turn on whether wagers are involved and without regard to the predominance of skill or chance, such as Illinois, Texas and Ohio. States such as Ohio, Georgia and Illinois also may draw a distinction between exempt contests where the person paying the entry fee actually competes in the sporting event and contests where the participants predict how others will fare in a sporting event.

So for example, the Derby Wars decision could be felt in Ohio, where in June 2016 the Ohio Attorney General issued an opinion letter stating that if the fantasy sports contest prize consists of the entry fees paid by the participants the contest could be illegal under state law. The Derby Wars decision enhances that possibility.

Similarly, should California treat contest entry fees for DFS operators outside horse racing as bets or wagers, the California Penal Code prohibits bets or wagers on any contest "of skill, speed or power of endurance of person or animal, or between persons, animals or... upon the result... of any... chance, casualty, unknown or contingent event whatsoever."

In addition, there are already lawsuits challenging fantasy sports contests pending in many states, including New York, Illinois, Massachusetts and Texas, and this ruling most certainly will now be cited by those opposing DFS.

In Derby Wars, the clear relationship between the entry fees and the prize pool led to the judgment that the entry fees are wagers. Those fantasy sports contests structured similarly to Derby Wars are likely to come under the same type of scrutiny regardless of the sport involved. On the other hand, when there is a great disparity between the entry fee and the prize(s) a court might be hard pressed to find any wager; the same may be true where the participants pay monthly subscription fees. But in any case, this ruling is certain to prove another hurdle for DFS operators in their bid to fight for legalization in the US on a state-by-state basis. The race is on between the courts and enforcement agencies on the rail and state-by-state legislation to legalize DFS.

David M. Fried attended the University of California at Berkeley, receiving his JD in 1988. He represents land-based casinos and suppliers. He appears before the California Gambling Control Commission and the California Department of Justice in licensing and regulatory matters and has processed gaming license applications and approvals in many other jurisdictions.