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DAILY FANTASY SPORTS IN VERMONT

Legal Possibilities and Ramifications

Presented to the House Committee on General, Housing, and
Military Affairs

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EXECUTIVE SUMMARY

In the past few years, the growth of the daily fantasy sports (DFS) gambling industry has been remarkable. A derivative of season-long fantasy sports, participants in daily fantasy sports can win monetary prizes depending on the success of the roster (collection of players) they select. In the past year, a number of states have legalized daily fantasy sports and introduced regulations for the industry. The Vermont Senate, too, passed similar legislation in February 2016. Yet, substantial holes exist in legal and regulatory knowledge; that is, little evaluative research exists regarding the design and success of state regulatory regimes. The Vermont House Committee on General, Housing, and Military Affairs is interested in answers to questions concerning the policies of other states, legal precedents, and the extent to which the industry should be regulated.

1. INTRODUCTION

On March 7, 2016, Virginia Governor Terry McAuliffe made history, settling a controversy in Richmond that continues to brew in the state capitals across the U.S. Signing legislation to legalize daily fantasy sports, Virginia became the first state in the United States to regulate and license daily fantasy sports operators.¹ Three states quickly followed.

In only five states, daily fantasy sports is banned—and legislation is pending in most of them to permit these prize-awarding competitive sports games. In several other states, too, where the debate over daily fantasy sports continues, similar legislation is pending. Vermont is one of those states.²

In Vermont, all gambling is illegal (with the exception of the state lottery), and the Attorney General has stated that this prohibition applies to daily fantasy sports.³ Enforcement remains minimal, however, and legislative interest in daily fantasy sports is robust. The Vermont Senate passed legislation to legalize daily fantasy sports in February of 2016.⁴ Advocates argue that daily fantasy sports avoids “the game of chance” characteristic that constitutes other forms of illegal gambling; that is, participants are able to *choose* the players in their lineup on the basis of the known skills of those players. In assembling a lineup that will be ultimately scored, then, participants exercise a great deal of autonomy over their prospects of winning.

So why might Vermont be interested in regulation? Benefits include potential revenue sources for the state (taxation and fees), as well as regulated service of a commodity that is enjoyable for many, yet risky for some. To the contrary, concerns remain about compulsive gamblers and predatory gambling by highly experienced players. Many questions remain unanswered: why would and how does a state legalize daily fantasy sports games? By outlining the regulatory schemes of states who have regulated DFS, as well as proposed schemes, this brief seeks to address these questions as well as identify topics of future inquiry in the context of Vermont.



1.1 Background Information

In a fantasy sports game, participants choose players of a specific sport, earn points, and win based on the performance of those players in games and competitions. Usually, players are put into “lineups” that are scored against the lineups of other participants in public or private leagues. There are both season long and daily fantasy sports formats. At the end of the time period—a single day or weekend for daily fantasy sports—results are tallied and a winner is announced. The appeal of daily fantasy sports gambling is derived from the quick-return nature of the games; for winning players, short-term competitions still yield prize earnings. While assessments of the demographics of fantasy sports participants vary, most tend to show a market dominated by younger, middle class, Caucasian males.⁵

Male	Female	Caucasian	Participants with Average Household Income of \$75,000 or Greater	Avg. Household Income*	Participants Aged between 25 and 35	Avg. Age*
98%	2%	91.6%	59%	\$77,000	51%	37.7

Figure 1: Demographics of Daily Fantasy Sports Participants in North America⁶

*Denotes the results of FSTA Market Study, listed in and consistent with the Eilers Research report.

1.1.1 The Rise of Daily Fantasy Sports

Since the launch of industry leader, FanDuel, in January of 2009, the growth of the daily fantasy sports gambling industry has been meteoric. This has been particularly true in the past three years. Through 2012, the average daily fantasy sports player spent \$5 on league-related costs, single player challenge games, and league related-materials. In 2015, the average daily fantasy sports player spent \$257 on the same items.⁷ Similarly, for DraftKings, which, coupled with FanDuel, accounts for 95 percent of the daily fantasy sports gambling market, entry fee revenue grew from \$45 million in fiscal year 2013 to \$304 million in fiscal year 2014.⁸ The growth of FanDuel has been similar: entry fee revenue went from \$159 million in 2013 to \$622 million in 2014.⁹ In the future, the industry anticipates growing revenues, although state efforts to legalize and/or prohibit will largely impact the magnitude of revenue growth.

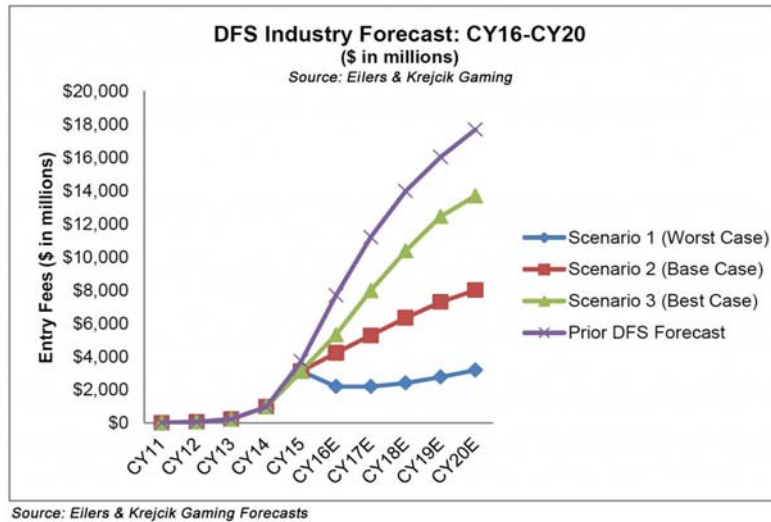


Figure 2: Forecast of Growth of the Daily Fantasy Sports Industry¹⁰

*Scenarios based on the number of states that legalize or prohibit daily fantasy sports

1.1.2 The Benefits of Daily Fantasy Sports

The main appeal of season long fantasy sports competition is its social component. Leagues are usually comprised of friends and offer an easy way for them to stay in contact.¹¹ Along with this, sports fans are given an opportunity to put their knowledge to use, and potentially be rewarded for it. Players, as a result, are more interested in and have more fun watching sports competitions as they have a vested interest in the outcome. Daily fantasy sports gambling has many of the same social benefits as season long fantasy sports, with the added bonus of a cash prize. Daily fantasy sports gambling is marketed as an almost purely skill-based form of gambling: the more contestants know about a selected sport and the more time they invest in selecting their players, the more likely they are to win.¹² However, some players aroused public outcry in arguing that the “skill-based game” claim is not entirely true; this was a major impetus for government scrutiny of daily fantasy sports.

1.1.3 Player Grievances

The main grievances of players include unfair contests, unauthorized third party programming, and false advertising.¹³ A practice known as “bumhunting,” too, has prompted complaints. Bumhunting originated in the arena of online poker, wherein highly experienced and well-funded gamblers would intentionally identify and compete against inexperienced players in order to win money.¹⁴ This practice has become prevalent in daily fantasy sports competitions; professional players use their superior sources of capital to invest in third party programming that allows them to change and submit dozens, if not hundreds, of lineups in contests that are otherwise filled with players unwilling to spend more than it costs to enter a handful of lineups (it often costs \$5-\$20 per lineup).¹⁵ This practice results in a disproportionate amount of prize money going to those that can commit the most monetary resources to the games, which has led to claims of deceptive



advertising because companies often depict an average sports fan winning a lot of money. To the contrary, around 90 percent of players experience net losses in daily fantasy sports gambling, and in one instance, during the first half of the 2015 MLB season, 1.3 percent of players took home 91 percent of prize money.¹⁶

1.1.4 Federal Laws Governing Fantasy Sports

A number of laws raise questions about the legal risks to which daily fantasy sports might be subject. First, the 1961 Wire Act prohibits betting through a wire communication. Application of the Wire Act to the internet remains underdeveloped—at least one court has determined that the internet is a wire communication. And while the Justice Department has not prosecuted anyone under the Wire Act, the very recent emergence of daily fantasy sports might account for this. The Uniform Internet Gambling Act of 2006 (UIGA) requires businesses who process betting transactions to refuse transactions if they know that the origin of the bet is a state that prohibits gambling. An enforcement bill, the UIGA contains a three-part test carve-out for daily fantasy sports. While DFS often meets the test, some worry that the limited duration of daily games makes luck a foundational component of winning. Lastly, the 1992 Professional and Amateur Sports Protection Act (PAPSA) makes it illegal for a person to operate a “wagering scheme based...on one or more competitive games in which amateur or professional athletes participate...”¹⁷ While this statute seems to explicitly prohibit daily fantasy sports, it was the U.S. professional sports leagues who lobbied for this law, and given their frequent partnerships with fantasy sports leagues, it seems unlikely that PAPSA would be leveraged against DFS.¹⁸ Notably, major DFS operators are present in 40 states, and in the 10 states that major operators do not serve, it has been state governments—not federal officials—that have moved to expel the industry. Therefore, it appears that the potential legal roadblocks to DFS are relatively insubstantial.¹⁹



3. REGULATORY SCHEMES

3.1 *Ensuring Competitive Equity*

Every state that has promulgated regulations for daily fantasy sports restricts employees of DFS operators from participating in DFS competitions. These restrictions extend to relatives of employees should those relatives live in the same household as the aforementioned employee. Several states, such as Tennessee, Massachusetts, New York, and Virginia, have also codified rules to restrict those who influence the results of DFS competition from participating. At the most basic level, such regulations prohibit professional athletes from betting on their own performance, yet these prohibitions also extend to those who play influential roles in the aggregate, like referees, coaches, and sports agents. Designed to level the playing field among participants, participant restrictions appear quite foundational to state regulations.

3.1.1 *Limited Player Entries*

States with more extensive regulatory regimes, like New York, Massachusetts, and Tennessee, limit each DFS participant to one account. Verification measures require that DFS operators employ reasonable means to ensure compliance with this rule, such as monitoring the locations of players. Mandates to identify and report proxy accounts—multiple accounts by the same person—are intended to eliminate the prospect of a single DFS participant crowding a given competition to increase his or her statistical odds of winning. Additionally, it is possible that, absent these regulations, highly experienced players could create additional accounts to circumvent restrictions and enter contests created for beginner participants.

Related to the number of accounts a player may hold is the number of entries a player may submit. An “entry” refers to the line-up of athletes the participant wishes to submit to the contest, analogous to one’s “hand” in a game of poker. Some states do not appear to have limitations on the number of entries a single participant may submit; however, DFS operators often have their own entry limits regardless. Some states do explicitly regulate the number of entries per player, though. Colorado law, for example, states that no player shall submit more than three percent of all entries or one hundred fifty entries—whichever is less—should the contest contain at least 100 entries. New York law uses the same language. While DFS legislation in Colorado and New York does not explicitly prescribe entry limits for contests with fewer than 100 players, it is likely that those states’ gambling commissions will prescribe entry limits or create standards—“fairness,” for example—by which DFS operators must abide. Alternatively, Massachusetts requires the establishment of entry limits, even for the smallest competitions. In contests with 12 or fewer entries, a participant may not submit more than one entry; in contests with 12-36 entries, a participant may not submit more than two entries; in a contest with 37-100 entries, a participant may not submit more than three entries; and in a contest involving 100 or more entries, a participant may not submit more than three percent of total entries or 150 entries,



whichever is less. The regulatory language in Massachusetts places the burden on DFS operators to ensure that entry limits are being followed. Regulations promulgated by the state of Tennessee are nearly identical to those of Massachusetts.

3.1.2 Prohibition of Scripts

Scripts, or software programs that perform complex analytic and statistical functions, have been banned by a few states. In the context of DFS, scripts are alleged to give participants an unfair advantage by producing automated line-up manipulations, facilitating automated multiple contest entry, and collecting large, aggregated amounts of information about contest competitors—tasks that would be burdensome or impossible manually. The prohibition of scripts attempts to eliminate asymmetries between those who possess the awesome power of scripts and those who do not.

3.1.3 Identification of Experienced Players and Beginner Contests

Amid concerns that highly skilled players are preying on newcomers and that a disproportionate amount of prize money is won by a small number of participants, some states have implemented regulations designed to help beginners navigate the DFS world. In Tennessee, Massachusetts, New York, and Colorado, DFS operators are required to very visibly identify highly experienced players. Such identification often takes the form of a symbol next to the username of a highly experienced player. Tennessee and Massachusetts have implemented an additional layer of protection as well. In these two states, DFS operators are required to offer contests in which highly experienced players cannot play. DFS operators are required to monitor for proxy accounts and the indirect play of highly experienced players.

3.2 Consumer Protections

Of the states that regulate daily fantasy sports, all but one require that participants be at least 18 years old. Many of these states require that DFS operators verify the age of participants through various means. In New York, parents are able to call a toll-free number to restrict their children from registering with daily fantasy sports operators. In Massachusetts, participants must be at least 21 years old.

Colorado, Indiana, Maryland, Massachusetts, and New York explicitly prohibit DFS contests based on the performance of college or high school athletes given that many amateur athletes are, in fact, minors. Related to this are regulations promulgated by a number of states that bar DFS advertisements at colleges, high schools, elementary schools and their sports venues. Regulations prohibiting DFS contests for amateur sports are largely preventative, as no major DFS contests exist for high school or elementary school sports. Massachusetts also requires that all DFS advertisements include information about assistance for problem gamblers.



3.2.1 Gambling Addiction

There exists no consensus concerning the impact of daily fantasy sports on gambling addiction. In fact, a recent study noted how little scientific inquiry has been devoted to the relationship (or lack thereof) between DFS and gambling addiction. That is, little, if any, evidence exists to suggest that a DFS is (or is not) a uniquely addictive activity. Of course, broad anecdotal accounts suggest that DFS is addictive for the same reasons that other activities are addicting: the thrill of risk and reward. The study first referenced in this subsection, too, found a correlation between those who play fantasy sports for money and those who experience gambling-related problems. Researchers have also documented that internet gambling presents unique addiction risks given its widespread accessibility (at home, at work, etc.) and the transactional ease of the internet.

To combat the risk of addiction, states have implemented a couple of regulations. Massachusetts and New York require that DFS operators publish resources for compulsive gamblers on their websites. The concept of self-restriction, too, remains a tool on which many states rely. Colorado, Indiana, New York, Massachusetts, Mississippi, and Tennessee mandate that DFS operators enable players to restrict themselves from DFS contests.

3.2.2 Financial Protections

To mitigate the financial risk that DFS poses, compulsive or not, states have moved to cap monthly deposits (the money one uses to pay an entry fee) to DFS operators. Tennessee regulations limit consumer deposits to the DFS operator to \$2,500 per month, unless the participant can demonstrate s/he is entitled to an increase in the cap. To meet the criteria, the participant must have an annual income of \$150,000 (\$300,000 if s/he has a spouse) or a financial net worth greater than \$500,000. Similarly, Massachusetts limits monthly deposits to \$1,000 unless it can be verified that the participant's finances warrant an increase. Following the alteration, the DFS operator must annually assess the ability of participants to afford higher caps. The state of Maryland also imposes a \$1,000 monthly deposit limit, subject to change on a case-by-case basis.

In Indiana, state regulators have sought prevent participants who owe child support payments from collecting DFS winnings. Regulation requires that DFS operators withhold the amount of delinquent child support from participant winnings, and send those winnings to the state government. The extent to which this rule will be feasible or successful is unclear.

3.3 Licensure Procedures

States have largely elected to incorporate DFS regulators into the existing bureaucratic structure. Most have created fantasy sports-specific offices in their gambling regulation bureaus, and a number of states have created study commissions tasked with promulgating rules designed to address the technical minutiae of DFS regulation issues. In Colorado and



Indiana, regulatory fees must be sufficient to finance the cost of administration. The cost of administration likely varies by state, depending on the quantity of regulation and regulators.

3.3.1 Application, Licensure, and Relicensure

In general, a process of application, licensure, and relicensure has been adopted by the states that regulate daily fantasy sports. Where differences arise is the length of time between licensure and relicensure. In Indiana and Tennessee, the time between licensure and relicensure is one year; by contrast, in New York, the state gaming commission relicenses interested DFS operators every three years. In Illinois, where daily fantasy sports is not yet legal, legislation was proposed that would impose relicensure for operators with revenue greater than or equal to \$100,000 every two years, and for companies with revenue less than \$100,000, every three years. Depending on the fees and costs associated with relicensure, the duration of time between licensure and relicensure can be more or less of a burden on operators.

Additionally, all states that regulate DFS mandate that operators conduct an annual audit. The audit must be performed by third-party Certified Public Accountant and funded by the operator. This is designed to ensure compliance with the regulations promulgated by each state.

3.4 Potential Revenue

Just as licensure regimes vary across states on the issue of license length, they also vary on the issue of license cost. In Mississippi, there is no licensing fee. At the other extreme, Indiana regulation sets the initial licensure fee at \$50,000, though it can be increased to \$75,000 should the cost of administration demand it. There is a subsequent annual *relicensure* fee of \$5,000. In Virginia, there is a non-refundable application fee of \$50,000, and the application fee itself does not necessarily guarantee licensure.

Some states take a more graduated approach. In Tennessee, the initial application fee is \$300, as is the relicensure application fee. Then, depending on an operator's annual adjusted revenue multiplied by percentage of entry fees collected from Tennessee consumers, there is an additional licensure fee (and relicensure fee in subsequent years). In terms of (re)licensure fees, the Tennessee schematic is more costly than many other states.

Operator's annual adjusted revenue multiplied by resident percentage	Relicensure fee
Greater than or equal to \$2,000,000	\$75,000
Greater than or equal to \$1,000,000 but less than \$2,000,000	\$50,000
Greater than or equal to \$500,000 but less than \$1,000,000	\$22,500



Greater than or equal to \$100,000 but less than \$500,000	\$10,000
Greater than or equal to \$50,000 but less than \$100,000	\$5,000
Greater than or equal to \$10,000 but less than \$50,000	\$2,500
Less than \$10,000	\$1,000

Figure 3: Graduated relicensure fee for DFS operators in Tennessee

A potential benefit of a graduated fee scheme is the inclusion of smaller operators in the market. For start-ups or medium-sized companies, high fees for initial application might be a strong deterrent to entry in a state’s DFS market. It appears likely, too, that the tolerance of more companies will produce greater revenue for the state.

At the lower end of cost, legislation in Missouri that has yet to pass illustrates a far more conservative relicensure fee regime. The initial application fee is \$10,000 or ten percent of net revenue, whichever is lower, and there is a subsequent relicensure fee each year. This legislation also provides that an annual operation fee be paid to the state in the amount of six percent of the operator’s annual net revenue.²²

Operator’s annual net revenue	Relicensure fee
Greater than \$2,000,000	\$5,000
Greater than \$1,000,000 but less than or equal to \$2,000,000	\$2,500
Greater than \$100,000 but less than or equal to \$1,000,000	\$1,000
Less than \$100,000	\$0

Figure 4: Proposed graduated relicensure fees for DFS operators in Missouri (HB 502)

In Illinois, House Bill 3655 would prescribe a more moderate graduated fees regime based on annual sports contest revenue:

Operator’s annual sports contest revenue	Application fee	Licensure fee	Relicensure fee
Greater than \$10,000,000	\$25,000	\$50,000	\$37,500
Less than or equal to \$10,000,000 but greater than \$5,000,000	\$12,500	\$25,000	\$18,750



Less than or equal to \$5,000,000 but greater than \$1,000,000	\$7,500	\$15,000	\$11,250
Less than or equal to \$1,000,000 but greater than \$100,000	\$5,000	\$10,000	\$7,500
Less than \$100,000	\$500	\$1,500	\$1,125

Figure 5: Proposed graduated relicensure fees for DFS operators in Illinois (HB 3655)²³

*This legislation has not passed.

Alternatively, Colorado classifies DFS operators based on size. For operators who have 7,500 or fewer players, there are no annual fees (they must still register, however). Operators with more than 7,500 players are subject to annual fees yet to be determined.

3.4.1 Taxes

Taxes are another revenue mechanism, either in conjunction with or to the exclusion of annual fees. In New York, there is a flat 15 percent tax on gross revenue earned in the state. Additionally, the state imposes a 0.5 percent tax for DFS akin to an annual fee that may not exceed \$50,000. Official licensure in New York, however, occurs every three years. By comparison, Missouri taxes operator net revenue²⁴ at 11.5 percent and Tennessee taxes revenue generated by state residents at six percent.²⁵ These taxes are distinct from corporate income taxes, though corporate income tax would only be assessed in states where DFS operators have offices, assuming they make profit.

By comparison, HB 3655 in Illinois would institute a graduated tax regime (in addition to the graduated fee regime explained above):

Annual sports contest revenues	Tax rate on annual sports contest revenues
Less than or equal to \$1,000,000	5%
Greater than \$1,000,000, but less than or equal to \$3,000,000	7.5%
Greater than \$3,000,000 but less than or equal to \$8,000,000	10%
Greater than \$8,000,000 but less than or equal to \$15,000,000	15%



Greater than \$15,000,000 but less than or equal to \$25,000,000	22.5%
Greater than \$25,000,000	30%

Figure 6: Proposed graduated tax regime for DFS operators in Illinois (HB 3655)

In an email conversation with DraftKings, we were told that their estimate for industry revenue in Vermont was around \$400,000, which may be useful to keep in mind when considering the implementation of a tax system. And while some states tax gross revenue, other figures like net revenue have been subject to taxation alternatively.

3.4.2 Regressive Taxation

A central criticism of gambling as a whole is that it acts as a regressive tax, meaning that a smaller percentage of a rich person's income will be gambled away on a bet than that of a poorer individual. This criticism seems to be largely inapplicable to Daily Fantasy Sports. As the aforementioned demographics data indicates, nearly 60 percent of players have household incomes of more than \$75,000 annually. Moreover, 37 percent of fantasy sports gamblers report not having set foot in a casino in an average year. Similarly, 42 percent of players spend less than \$100 weekly on Daily Fantasy Sports, with 46 percent of players preferring competitions with an entry fee of under \$5.²⁶ This data indicates a middle class consumer base that, in general, does not put itself at much financial risk when playing Daily Fantasy Sports.²⁷

4. INDUSTRY INPUT

The Policy Research Shop conducted interviews with representatives from both FanDuel and DraftKings, the two largest companies in the fantasy sports market. These interviews yielded industry perspective on the extent and composition of regulations.

Both FanDuel and DraftKings representatives stressed the importance of regulation consistency across state lines. Because DFS contests are not restricted to state boundaries, too much variation in state regulation regimes can impose a great burden on DFS operators, ultimately stifling their product. Legislation proposed in Vermont to legalize and regulate DFS would mirror many of the regulations found in other states.

There appeared to be consensus among FanDuel and DraftKings that it is too early to determine the impact of state regulations on business operations. Little to no data exists concerning revenue (for both operators and the states who tax them) or growth. Regardless, FanDuel noted that the New York legislation had been beneficial for business. DraftKings noted, too, that it supported the New York tax regime (15.5 percent) and did not think that the prospect of taxation would substantially impact the company's finances. Instead, DraftKings stressed that DFS operators' business model depends heavily on entry fees, so



if contests do not fill, the operator can easily lose money. Even when contests do fill, 90 percent of the funds from entry fees are given as prizes, and so only 10 percent of the entry fees become net revenue for the company. Thus, people often confuse the magnitude of entry fees with that of net revenue.

5. CONCLUSION

The rapid growth of daily fantasy sports makes questions of DFS legality and regulation particularly salient. A growing number of states, including some in New England, are pushing forward with the implementation of extensive regulatory regimes. Thus far, Vermont has not followed suit. This brief details a range of consumer protections, application and licensure procedures, and revenue sources that might be of interest to state representatives interested in regulating this growing online industry. Of course, room exists for innovation, and further consultation with DFS operators or neighboring legislators might yield more nuanced and effective rulemaking.



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- ¹² *ibid.*
- ¹³ *ibid.*
- ¹⁴ *ibid.*
- ¹⁵ *ibid.*
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<http://www.washingtontimes.com/news/2016/feb/29/vermont-senate-passes-bill-to-legalize-daily-fanta/>

²² HB 502, 99 Cong.,

<http://www.house.mo.gov/billtracking/bills171/hlrbillspdf/1204H.01I.pdf> (2017).

²³ 3655, 99 Cong., <http://ilga.gov/legislation/fulltext.asp?DocName=09900HB3655sam002&GA=99&SessionId=88&DocTypeId=HB&LegID=89852&DocNum=3655&GAID=13&Session> (2016).

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²⁶ ibid.

²⁷ The regulations of the states listed in Section Three of this report can be accessed at the following URLs.

Colorado: www.leg.state.co.us/clics/clics2016a/csl.nsf/fsbillcont3/4F153CC1C580418687257F780057F3FD?Open&file=1404_enr.pdf and www.colorado.gov/pacific/dora/Fantasy_Contests_FAQ

Indiana: <http://iga.in.gov/static-documents/7/f/1/5/7f15fe9f/SB0339.07.ENRH.pdf>

Kansas: http://kslegislature.org/li_2016/b2015_16/asures/documents/hb2155_enrolled.pdf

New York: <http://legislation.nysenate.gov/pdf/bills/2015/S8153>

Maryland: http://comptroller.marylandtaxes.com/Media_Services/wpcontent/uploads/07-14-16-Fantasy-Sports-Regulations.pdf

Massachusetts: <http://www.mass.gov/ago/consumer-resources/consumerinformation/dfs/final-3-25-dfs-regulation.pdf>

Mississippi: <http://billstatus.ls.state.ms.us/documents/2016/pdf/SB/2500-2599/SB2541SG.pdf>

Missouri: <http://www.house.mo.gov/billtracking/bills161/billpdf/intro/HB1941I.PDF>

Tennessee: <http://share.tn.gov/sos/rules/1360/1360-03/1360-03-05.20160629.pdf> and <http://www.lexisnexis.com/hottopics/tncode/>

Virginia: <https://lis.virginia.gov/cgi-bin/legp604.exe?161+ful+HB775ER+pdf>