

## OUTSIDE COUNSEL

# Daily Fantasy Sports Decisions Risk Clouding Legal Landscape

The daily fantasy sports (DFS) industry is immensely popular in the United States, with millions of registered users and an estimated annual revenue in excess of \$300 million. *See* Dustin Gouker, *New Official Data: Daily Fantasy Sports Generated \$335 Million In Revenue In a Year*, Legal Sports Report, <https://www.legalsportsreport.com/21627/ny-dfs/> (last updated June 27, 2018). However, there have been several legal challenges to DFS at the federal and state levels, particularly concerning whether DFS contests should be considered a form of gambling. *See, e.g., In re: Daily Fantasy Sports Litig.*, No. 1:16-md-02677 (D. Mass. filed Feb. 4, 2016). Some state attorneys general have opined that DFS contests are gambling, and some states such as Nevada have determined that DFS operators must be licensed under state gambling regulations. Many other states have expressly

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concluded that DFS is not considered gambling, however.

The issue of whether DFS contests constitute gambling arises in part because, unlike betting on the outcome of a sporting event, DFS contests involve a substantial degree of skill, although chance arguably does play at least some part. When evaluating a contest that involves both skill and chance to determine whether it constitutes gambling, most state courts will apply either the material element test or the predominate factor test to decide if the contest is considered gambling. Under the material element test, a contest is considered gambling if chance is a material element in the contest. Conversely, under the predominate factor test (also commonly referred to as the dominant factor test), a contest is

not considered gambling if the dominant factor in the contest is skill.

Recent state court decisions in New York and Illinois have applied these two tests to DFS contests and have reached different conclusions about whether DFS is considered gambling. In February 2020, the New York Appellate Division, Third Department applied the material element test and found that DFS contests are unlawful gambling. *See White v. Cuomo*, 181 A.D.3d 76 (N.Y. App. Div. 2020). In April 2020, the Illinois Supreme Court applied the predominate factor test and found that DFS is not gambling. *See Dew-Becker v. Wu*, 2020 IL 124472. As discussed further below, these decisions have provided a lack of clarity about not only DFS, but also potentially other paid contests that involve skill and chance, such as esports.

### 'White v. Cuomo': The Material Element Test

New York law generally prohibits gambling, including games “in which the outcome depends in a material degree upon the element of chance, notwithstanding that

skill of the contestants may also be a factor therein.” N.Y. Penal Law §§225.00[1]-[2]. In 2016, the state Legislature added Article 14 to the Racing, Pari-Mutuel Wagering and Breeding Law (“Article 14”), which provides that, based on the nature of the contests, DFS contests “are not games of chance because... teams are selected based upon the skill and knowledge of the participants.” N.Y. Rac. Pari-Mut. Wag. & Breed. Law § 1400[1][a]. Article 14 further “declares that [DFS] do not constitute gambling in New York state.” *Id.* § 1400[2].

Despite this clear legislative finding, several New York residents brought suit seeking a declaratory judgment that Article 14 violates the New York Constitution’s prohibition on gambling. Justice Connelly of the state Supreme Court in Albany County partially granted the plaintiffs’ summary judgment motion, finding that Article 14 violates the New York Constitution to the extent that it authorizes DFS. Both parties appealed to the Appellate Division, Third Department.

In the majority opinion, the Appellate Division invalidated Article 14 in its entirety, finding that DFS contests constitute gambling because they involve a material degree of chance. However, the opinion demonstrates that—as Justice Pritzker wrote in his dissent—materiality is an “amorphous” term that can be difficult to apply in practice.

In applying the material element test, the court held that materiality must be qualitatively determined.

Curiously, the majority opinion acknowledged that skill is an important part of DFS contests. The court noted that research has shown that lineups chosen by contestants have a greater likelihood of winning contests than those chosen at random, and that contestants improve their performance over time. However, the court found the contests to be

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gambling because DFS participants cannot control the outcomes of the real-world games; as a result, the court found that these players ultimately cannot control the results of their own contests.

Critics of the holding are quick to point out that the court effectively found that DFS contests constitute gambling if they contain *any* element of chance. However, the court does not explain why materiality should be solely tied to the *outcome* of DFS contests. If the New York Court of Appeals considers the defendants’ appeal, it may determine the appropriate amount of focus or weight to be placed on the outcome of contests—as compared to the substantial skill needed to select a winning DFS team—when applying the material element test. The case also underscores the difficulty courts face in applying the material element test, which was

further underscored in the *Dew-Becker* case.

### 'Dew-Becker v. Wu': The Predominate Factor Test

Unlike New York’s Article 14, Illinois statutes do not specifically address DFS contests. Although the Illinois Criminal Code generally prohibits gambling, participation in a contest that “[o]ffers...prizes, award[s] or compensation to the actual contestants in any bona fide contest for the determination of skill, speed, strength or endurance” is not considered gambling. 720 ILCS §5/28-1(b)(2). Colin Dew-Becker lost \$100 to Andrew Wu in a head-to-head DFS contest and subsequently sued to recover his losses under an Illinois statute that allows a person who loses at least fifty dollars by gambling to recover the amount that he or she lost. *See id.* § 5/28-8(a). At trial, the Illinois Circuit Court found for the defendant. The Illinois Appellate Court affirmed and the plaintiff appealed to the Illinois Supreme Court.

In the majority opinion by Chief Justice Burke, the Illinois Supreme Court found that DFS contests are predominately skill-based, and thus the plaintiff had not engaged in gambling and could not recover his losses. In doing so, the court applied a quantitative approach to the predominate factor test and focused on the role that skill plays in DFS contests.

The Illinois Supreme Court chose to apply the predominate factor test, because it “provides a workable rule,” under which contests

are not considered gambling if the “outcome is mathematically more likely to be determined by skill than chance.” *Dew-Becker*, 2020 IL 124472 ¶ 25. The court rejected the material element test because it “depends too greatly on a subjective determination of what constitutes ‘materiality.’” *Id.* In applying the predominate factor test, the court cited to several recent studies that have concluded that DFS contests are predominately determined by the skill of the participants. On the basis of these studies, the court found that it is now “widely recognized” that DFS contests are predominately skill-based. *Id.* ¶ 26.

Unlike the majority opinion in *White*, which made a *qualitative* assessment of whether chance is a material element, the *Dew-Becker* court took a *quantitative* approach to determine whether skill predominates over chance. Furthermore, the *Dew-Becker* majority generally considered the skill involved in *creating* lineups for contests, rather than focusing solely on whether chance impacts the outcome of DFS contests. The court noted that the relevant skill of DFS participants included their “knowledge of statistics and the relevant sport to select a fantasy team that will outperform the opponent.” *Id.*

In dissent, Justice Karmeier’s application of the predominate factor test in many ways mirrored the *White* court’s application of the material element test by taking a qualitative approach and focusing

on participants’ inability to control completely the *outcome* of DFS contests. As with the *White* majority opinion, Justice Karmeier’s version of the test arguably requires the elimination of all aspects of chance, effectively converting the predominate factor test into one in which skill must be the *sole* factor.

### Looking Ahead

Going forward, courts considering whether DFS contests constitute gambling may look to these two decisions for guidance. The material element and predominate factor tests provide courts and litigants with direction, but as these recent opinions demonstrate, the material element test can be challenging to apply. As Justice Pritzker noted in his dissent in *White*, “materiality” is an amorphous term that often requires a subjective determination. Even though the majority in *Dew-Becker* found that the quantitative application to the predominate factor test provided a “workable rule,” Justice Karmeier noted that other courts have taken a qualitative approach to the same test and arrived at a different result.

If the *White* decision stands, DFS contests may continue to face the question of whether they constitute gambling, even in states such as New York where DFS contests have been declared legal by the Legislature. Paid contests that arguably involve a mix of chance and skill also have emerged in esports. As esports operators that

offer paid contests approach the height of their popularity, they may face similar challenges as DraftKings and FanDuel have faced at the state and federal levels. Given the disparate approaches to evaluating paid contests involving chance and skill, esports and DFS operators not only should be aware of the various tests, but also of the ways in which courts apply them.