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Identifying New Pari-Mutuel iGaming Offerings in the United States

by

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Part One

Introduction

The online gaming industry in the United States is in transition. Currently, the only legal interstate online gambling option is betting on horse and dog racing. Unfortunately, the horse and dog racing industry has been in a secular decline for decades, with declines in handle and an aging and diminishing customer base. There are legislative discussions at both the federal and state level with regard to expanding online gambling to include poker and lottery.

Online skill gaming is well established, with the explosion in fantasy sports occurring over the last decade. Approximately 30 million Americans play fantasy sports, predominantly online (Amic, 2011). In preparation for expanded legal online gambling, traditional gambling games, such as poker, casino games and slots have become available in a free-play or subscription mode.

An academic survey of current online gaming offerings is of interest, particularly focused on sports gaming, which was done in a professional paper format. The paper consists of a blend of a literature review and case study. The literature review consisted of disclosing various online entrants and offerings in the fantasy sports and pari-mutuel Advanced Deposit Wagering marketplace. The case study portion consisted of reporting, where available, market results or success of various entrants and offerings as well as providing specifics of potential differentiated pari-mutuel fantasy sports game offerings.

Purpose

The purpose of this paper is to develop a competitive landscape of current offerings in the online fantasy sports and online pari-mutuel wagering market in the US and to determine potential differentiated pari-mutuel sports iGaming offerings based on that landscape.

Statement of Objective

The study will identify the breadth of current and offerings in the online fantasy sports industry in the US as well as identified the breadth of current offerings in online horse and dog racing Advanced Deposit Wagering (ADW). In addition, where obtainable, market results of these various offerings will be discussed.

Justification

The results of the paper will be used as part of the business planning process for a new skill game and regulated wagering internet gaming (iGaming) entrant. This entrant was conceived as a result of identifying the opportunity to expand pari-mutuel wagering beyond traditional horse and dog racing to exploit the dramatic growth of fantasy sports, reality shows and other human contests.

Constraints

The first constraint was the scope and scale of publicly available material. The majority of the companies and offerings explored were either private or a small portion of a larger public entity, limiting the amount of on-point, standalone information, particularly with regard to detailed reported results. Online sources were the primary source of company information, augmented with selected information generated from the new gaming startup company.

The second constraint was the amount of introductory material presented. The objective of the paper was not to be a history of the fantasy sports and pari-mutuel industries. However, within this constraint, a sufficient background was presented in order to ensure interest and utility to a wider audience than just those with a significant prior knowledge of these industries and markets.

Part Two

Introduction

This section discusses various aspects underlying the competitive landscape for online fantasy sports and online pari-mutuel wagering in the United States. The following literature review begins with describing what fantasy sports are, general market size and demographics, in addition to the social entertainment aspects surrounding these games. The topic then changes to discuss the primary animal racing sports in the United States, along with information regarding the decline in popularity of this sport and amounts wagered. Following that, several key Federal statutes that set the general boundaries and framework for online wagering and skill games such as fantasy sports are presented. To conclude the legal literature review, a primary case holding regarding the fantasy sports business and its relationship with the First Amendment was presented. With this overall background, detail on typical online fantasy sports and racing wagering websites were introduced, along with additional detail on how sites even in the same game genre differ, to include business model and monetization description.

Literature Review

Multiple sources were consulted to capture the breadth and depth of the various topics relevant to this study. Sources included academic and various company literature, industry presentations, federal statutes and case law. The company material cited, in particular the Yougaming.com material, was published previously or publicly releasable. Material such as consumer demographics, fantasy sports market size and market share estimates for fantasy sports sites was difficult to obtain, but to the extent possible was captured.

What are Fantasy Sports

Fantasy sports is a type of skill game where participants select a number of real-world sports or event participants to craft a virtual team, which certain performance statistics or metrics are accumulated from those real-world sporting or other events, and compared with similar metrics from competing virtual teams to determine the fantasy game outcomes. Fantasy sports games have expanded beyond professional sports to include such things as movies, soap operas and politics.

Demographics

The average fantasy sports consumer is a lucrative demographic. Walker and Lee (Walker & Lee, 2007) investigated the fantasy sport consumer. In general, they identified the typical fantasy sports consumer demographic as: 70% male, 45% of consumers being within the 25-49 age group, 53% having household incomes higher than \$75,000, and 30% having household incomes higher than \$100,000.

Amic presented current research into the fantasy sport markets (Amic, 2011). The United States and Canada are the most established fantasy sports markets. In the United States population 12 and older, 19% of males, 8% of females, 18% of those with a college degree, and 16% of those with a \$50,000 or higher household income participated in fantasy sports within the last year. In the Canadian population 12 and older, 20% of males, 5% of females, 22% of those with a college degree, and 15% of those with a \$50,000 or higher household income participated in fantasy sports within the last year.

Overall, the direct market size of the fantasy sports industry is estimated at \$800 million, with a total market impact of \$4.48 billion (Amic, 2008). The fantasy sports consumer is a valuable and lucrative demographic, even in this current economic climate.

The fantasy sports industry is large, but not consolidated. There are some large players, but almost half of the fantasy sports consumers participate in offerings that are not provided by the top four competitors. As will be discussed in other sections, fantasy sports leagues have moved to an online format, for ease of statistics compilation and league management. The current estimated market share of the fantasy sports market in the US and Canada is:

- Yahoo – 23%,
- CBS Sports – 14%,
- ESPN – 13%,
- Fox Sports – 3%, and
- Other – 47% (Amic, 2008).

More recent numbers that track unique visitors, which could be used as a rough gauge of market share, was developed by Compete.com and published by Fantasysportsbusiness.com.

The following show the top fantasy sports sites by unique visitors in September, 2010:

- Yahoo – 6,115,130,
- ESPN – 5,461,712,
- NFL – 2,709,801, and
- CBS Sports – 1,940,999 (Fantasysportsbusiness.com, 2010).

What is important to note in these more recent numbers is the emergence of a sports league-operated fantasy sports site being in the top tier. Sports leagues to date only offer free play fantasy games, but there is no barrier to them offering pay-to-play games.

History

The fantasy sports industry was founded in the US, and the US and Canada are the largest markets. Fantasy sports are becoming more popular elsewhere, but the larger prevalence of

sports betting in other jurisdictions is an acceptable substitute offering. Although the leading fantasy sports operators have material shares of the market, the market overall is still fragmented.

The key technological change in the fantasy sports industry has been the transition to the Internet. In the beginning - the first fantasy football draft was in August 1963 - all fantasy sports games were handled on paper. Drafts, statistics compilations, winners and losers, etc., were all handled on paper (FSTA.org, 2007). With the emergence of the World Wide Web in the 1990s, online methods became feasible. Now, only a small minority of fantasy sports games are handled on paper. For example, many NCAA “March Madness” bracket games are still handled on paper. That kind of prognostication game, however, does not squarely fall into the realm of fantasy sports as it is more akin to sports betting pools.

The Internet is the common means to handle the vast majority of fantasy league tasks. A notable exception are those leagues that are composed of friends, co-workers, and family where part of the fun of the fantasy sport experience are the physical gatherings at the fantasy draft and the end of league celebrations.

Social Interaction

As stated, part of the popularity of fantasy sports is the social interaction between the game participants. Often, the annual fantasy league draft is a big social event, combining camaraderie, food, drink, trash talk, as well as the primary task of selecting each person’s initial fantasy roster. Highlighting the social aspects of fantasy sports, the FX television network airs a comedy, called “The League.” The comedy revolves around a group of people in a fantasy football league, their lives and their attempts to win the league (Fxnetworks.com, 2011).

The social interaction can extend further than one’s league. Many sports-related websites have substantial fantasy sports content, including user-generated content. This user content may

be as minimal as comments to articles, or as extensive as independent player analysis and projection or detailed fantasy sports reporting. Fantasy sports sites can additionally leverage the social aspect of the game to enhance the stickiness of their sites by including various side contests or content that can provide the ability for users to gain reputation among the site's visitors with respect to accuracy of projections, success of their fantasy team or popularity of their user-generated content.

User-generated content does have potential negative consequences, however. The three primary areas where user-generated content can land a website in trouble are copyright infringement, aiding and abetting liability for criminal conduct, and prohibited content (e.g. indecent material). To assist in providing safe harbor protection, sites can implement protective measures such as an acceptable use policy and terms of service, a copyright policy, and requiring users to register and access with a username/password (Colton, 2011).

Animal Racing in the United States

Racing is the only sport which can offer online interstate wagers in the United States, due to the restrictions of the Wire Act (Law.Cornell.edu, 2011d). The dominant racing sport is horseracing, with both thoroughbred and standardbred (harness) racing available in many states. To a much lesser extent, dog racing (greyhound) is also available. The allowed wagering methodology for racing is the pari-mutuel wagering method, as opposed to fixed-odds wagering, commonly used for other sports betting. The racing industry in the United States has been undergoing a slow but steady decline for years, with wagering handle in 2010-level dollars declining 37% since 2003 and declining 49% since 1975 (Lamb & Singer, 2011).

Other metrics tell a similar tale of a sport in serious trouble. Attendance at racetracks has declined 4% per year since 1993. Horse starters are down 23% since 1990. Race days at tracks

have declined 14% since 2000. Horse racing fans are declining at 4% per year, with half of those due to death. The average age of horse racing fans is 51, expected to increase to 57 by 2020 (Lamb & Singer, 2011). The future is just as bleak. The estimates for various metrics for horse racing in 2020 are: wagering handle down by 25%, foal crop (baby horses) down by 9%, number of racetracks down by 27%, state revenue down by 25%, and horse owners' losses up by 50% (Lamb & Singer, 2011).

The metrics for dog racing, although not stated, are similar with regard to lower wagering handle, for example (Ketterer, 2008). Like horse racing, dog racing also uses the pari-mutuel method of wagering, and the dog racing industry faces similar issues as the horse racing industry. Two major efforts have occurred that have helped keep the economics of horse racing afloat, in spite of the secular decline of the sport.

The first effort was the passage of the Interstate Horse Racing Act in 1978 to allow off-track (also known as simulcast) wagers and its amendment in 2000 to allow wagering on races over the internet. This act has helped keep racing wagering handle from declining precipitously, due to the other factors mentioned previously. However, internet race wagering has a consequence in that this expanded wagering channel has the potential to cannibalize further on-track attendance and handle due to the convenience factor.

The second effort was the insertion of slot machine parlors at racetracks, making them known as racinos. The additional revenue from slot machines is steered toward race purses, helping the economics of those tracks. However, there does not as yet appear any evidence that slot machine players convert to become horse racing fans and bettors. An obvious question is "if you have racinos because casino gambling in competing markets is negatively impacting pari-

mutuel wagering in your market, why would you expect pari-mutuel wagering to improve if casino gambling is located in the same building or next door” (Ketterer, p. 15).

Legal Framework

There are a few key cases that lay the framework with regard to the legal basis for online pari-mutuel wagering and online fantasy sports contests. In general interstate wagering on sports events is forbidden by the Wire Act, and supplemented by the Unlawful Internet Gambling Enforcement Act (UIGEA) and the Professional and Amateur Sports Protection Act (PASPA) (Law.Cornell.edu, 2011b; Law.Cornell.edu, 2011c; Law.Cornell.edu, 2011d). In addition, there is a key case holding that cements the finding that player names and performance statistics are public domain, covered by First Amendment protections (Associated Press, 2008). The political and legal aspects of the fantasy sports industry are dealt with at multiple government levels, and cover multiple legal areas. Focusing on the US, the legal areas that impact fantasy sports are gaming law and intellectual property law.

Both state and federal law cover gaming. Each state has the ability to determine what level of gaming is allowed within the state, and what constitutes gambling. What may be considered a contest in one state may be viewed as prohibited gambling in another. Operators need to carefully examine their games with regard to both federal and state definitions of what constitutes a gambling game and its legality in each state which it wishes to do business, regardless if what is offered is designed to be a gambling or a game of skill.

Both state and federal law cover intellectual property. At the state level, some states have codified a principle known as right of publicity, which means that an entity, typically a person, has a right to use their identity for their economic gain, and puts limits on how much of a person's identity can be economically used by others without the person's consent or being

properly compensated. This form of property is different from intellectual property in the form of patents and copyrights, which are covered solely under federal law. Specific detail on these key cases is shown below.

Applicable Federal Laws and Cases

Wire Act 18 U.S.C. § 1084.

This law makes illegal the transmission of wagering information related to sporting events using wires, such as telephone, telegraph, etc. The law was passed in 1961 in an attempt to fight organized crime. The law still applies to sports betting in the Internet age, but does not apply to other online gambling games, such as slots, poker or roulette (Law.Cornell.edu, 2011d).

Professional and Amateur Sports Protection Act (PASPA) 26 U.S.C. §§ 3701-3704.

This law, passed in 1991, prohibits sports gambling within the US, with the exception of four states: Nevada, Oregon, Montana and Delaware. Each of those states either offers sports gambling now, such as Nevada, or has the ability at the state's sole discretion to offer sports gambling, such as the recent discussions in Delaware. Notably, this law specifically exempts horse and dog pari-mutuel wagering from enforcement by the statute (Law.Cornell.edu, 2011b).

A New Jersey state senator recently filed a challenge to this law on constitutional grounds, stating that it is unfair for the Federal government to allow some states to engage in a particular economic activity, and prohibit other states from engaging in the same activity, even if that activity is completely contained within a state. That suit was dismissed; however, the suit may be revived pending the outcome of an affirmative vote in a statewide referendum in November, 2011 (Nj.com, 2011).

Unlawful Internet Gambling Enforcement Act (UIGEA) 31 U.S.C. §§ 5361-5367.

This law, passed in 2006, specifically attacks online gambling by restricting the financial flow of funds between the wagering party, the financial institution and the internet gambling operator. Congress proposed legislation in 2007 to undo UIGEA without success. A similar bill has just been submitted.

In the UIGEA, there is a specific carve-out for fantasy sports, stating that if a fantasy sports contest operated under the following parameters, UIGEA restrictions and barriers would not apply. To fall under the carve-out, the fantasy games and virtual teams used as the basis of games need to comply with the following: can't be a 100% copy of an actual team, prize has to be set in advance, outcomes based on 2 or more actual games, and can't be based on scores of real teams (Rose, p. 44).

The repeal of this law will allow for regulation and taxation of online gambling, generating additional tax revenue and bringing this currently illegal activity out in the open. Major brick and mortar gaming operators in the US, as well as offshore online gaming operators that are not afoul of the current law, are supporting this new legislation. The repeal of this law should have no impact on the offering of a fantasy sports product operated as a contest or skill game as such games were offered before the passage of the UIGEA. Such a game could not be currently allowed in an online regulated gambling method, just like sports betting, due to the controlling law of the Wire Act (Law.Cornell.edu, 2011c).

Interstate Horse Racing Act (IHA) 15 U.S.C. §§ 3001-3007.

The modern structure of pari-mutuel wagering in the United States was established with the passing of the Interstate Horse Racing Act (IHA) in 1977, further amended in 2000. The IHA allowed the establishment of interstate wagering pools on races, which allowed the

expansion of off-track wagering. Previously, attendance at a particular track would limit wagering opportunities to just the races that day at that track. With the IHA, a track, provided it had the agreement in place, could offer wagering on races at other tracks, allowing races to attract betting interest nationally, as opposed to locally (Law.Cornell.edu, 2011a). A fuller description of what is pari-mutuel wagering is contained in the online racing wagering section.

With the amendment of the IHA in 2000, pari-mutuel wagering was expanded to the internet and ushered in Advance Deposit Wagering (ADW) and ADW operators. ADW operators may be a completely online entity, with no ownership or involvement in actual racing or track operations.

What is an ADW? An ADW is the common term used to identify an online pari-mutuel race wagering website which operates under a structure called advanced deposit wagering. A prospective bettor must first register with the website, providing proof of ability to place wagers, and deposit funds in advance. The proof that must be provided in advance can be as extensive as providing copies of driver's licenses, passports or even birth certificates. This prior eligibility screen is more robust than that employed by brick and mortar casinos. Once eligibility is provided and funds deposited in advance, the bettor then can via an online portal (website), make pari-mutuel wagers. Unlike fantasy sports contests, horse and dog racing ADWs offer bona fide online wagers.

CBC Distribution & Marketing v. Major League Baseball Advanced Media (CBC).

The sports leagues had initially ignored the fantasy sports industry and participants, at best, and ridiculed them as “nerds and geeks,” at worst. That changed when the industry began to grow in the 1990s. At that point, the leagues started pushing fantasy sports operators for license fees to allow use of player names and statistics, the same information found for free in

the newspaper every day. In 2006, Major League Baseball decided that they were going to grant only so many licenses, and that the fantasy sports operators could operate only the approved game format from Major League Baseball. CBC Distribution was likely not going to be one of the licensees, so they initiated a lawsuit seeking a declaratory ruling, *inter alia*, whether the use of player names and statistics were public domain and protected speech under the First Amendment. This was indeed the finding of the Court, which was defended through the 8th Circuit, and was denied a further hearing by the US Supreme Court (Associated Press, 2008).

This case finding was affirmed recently in the partial summary judgment granted to CBS in CBS Interactive v. National Football League Players Association. A Minnesota court found that the law in CBC was controlling in that football players' names and statistics, although not the same as baseball players' names and statistics, was a distinction without a difference (Sportsbusinessdaily.com, 2009).

At this time, fantasy sports operations in the US that limit their use of players' identifications to names and statistics, can do so under the protection of the First Amendment. If a fantasy sports operator used player pictures, game footage, team names or logos without permission and/or licensing from the various sport leagues, that could likely spur a further legal challenge.

Applicable State Laws.

It is common knowledge in the gaming industry that there are nine U.S. states that are very strict with regard to the definition of gambling. Most fantasy sports operators tend to avoid operating their online fantasy sports contests in the following states: Louisiana, North Dakota, Montana, Iowa, Arizona, Vermont, Maryland, Arkansas and Florida. It may be possible to

operate a fantasy sports contest in some of these states, if all of the operations were confined wholly within the state (Colton, 2008).

Online Fantasy Sports Contests

Fantasy sports contests have great variability with regard to game structure, prize structure, length of game and number of allowed contest participants. Fantasy sports websites can offer either free play or pay-to-play games. The pay-to-play games must operate in accordance with the restrictions outlined in the UIGEA (Downes, 2007). Enough companies were identified that covered the full range of variables.

How a free play online fantasy sports website earns income typically is via advertising. To make this kind of revenue model economically viable, the site must attract a very large amount of traffic. Currently, only sites such as Yahoo, ESPN and those run by the sports leagues themselves can attract that size of audience. The sites that focus on free play want to obtain as many visitors as possible and keep them on the site for as long as possible to maximize advertising revenue. What these sites have in common is substantial content, significant social interaction and in some cases, ancillary games that keep users on the site, along with the portal to access the fantasy sports games they are participating.

Previously, before law enforcement actions against companies for accepting advertising from offshore online gambling operators, small fantasy sports operators could have survived in a free play model, as the advertising revenue from these offshore gaming operators were sufficient. Now, for smaller free play fantasy sports websites, an advertising-based revenue model won't generate enough revenue. An overview of typical large free play fantasy sports sites is discussed below. The samples will bias toward fantasy football, the most popular fantasy sport.

Yahoo.com

Yahoo has a very complete and comprehensive fantasy sports presence. They host private leagues for multiple sports as well as have comprehensive and extensive coverage of both straight sports news but also fantasy sports-focused news. In addition, the site offers research, trends and other data mining gleaned from the aggregate of the site's leagues at no cost. There are also social networking aspects to their site with leader boards where top performing teams are touted, profile page where a user can have a space to showcase their historical fantasy sports success, message boards and a blog.

Yahoo does offer a couple of paid enhancements for fantasy. One is a premium scouting report that is delivered in a weekly newsletter format. The cost for this is \$9.99. The second premium offering is a trade review service for \$14.99. In many fantasy leagues, participants can "trade" players from one team to another, just like in real professional sports. However, there is the potential for trades that are unreasonably unbalanced with regard to value given and received. The trade review service utilizes Yahoo sports staff to evaluate the trade for fairness, and can overturn the trade in their discretion.

Depending on the sport, Yahoo can offer multiple types of fantasy games, which are free to enter. Persons can establish and manage a private league among their friends and colleagues or individually join a public league, managed by Yahoo. Most of these leagues have no prizes, but Yahoo is beginning to offer some pay-to-play games for their leagues, with prize payouts approximately 80% of the total entry fees (Yahoo.com, 2011).

ESPN.com

Similar to Yahoo, ESPN has a very complete and comprehensive fantasy sports presence. ESPN offers extensive coverage of both straight sports news but also fantasy sports-focused

news. In addition, the site offers research, trends and analysis at no cost. ESPN's fantasy sports presence also has social networking aspects to their site with leader boards where top performing teams are touted, profile page where a user can have a space to showcase their historical success, blogs as well as an arcade with several types of fun games like driving, trivia and puzzles.

Depending on the sport, ESPN offers multiple types of free to enter fantasy games. Differentiating from Yahoo, ESPN appears to focus more on shorter time span games, such as weekly contests, as opposed to the season-length fantasy games more affiliated with Yahoo. Also, many of the ESPN games provide prizes such as gift cards or even trips to Walt Disney World (ESPN.com, 2011).

NFL.com

The fantasy site run by this sports league only offer free play games, to include football-themed arcade games. What the NFL and other sports leagues have as an advantage is the organic rights to the games themselves, particularly audio and video. The NFL is able to monetize those who want additional video and audio content in order to assist them in their fantasy league. Additional monetization occurs with the online purchases of official NFL apparel, photos and personalized gifts.

The NFL site during games offers live scoring updates as well as detailed in-running reporting of games in progress, allowing fantasy sports participants a more immersive "multi-screen" experience. What this means is that a person can be watching a game live on television and using their computer or smart phone to access additional information during the game, expanding the overall sport enjoyment experience (NFL.com, 2011).

A pay-to-play online fantasy website primarily earns income from the entry fees paid by players. As stated earlier, these games must operate in accordance with the safe harbor structure

outlined in the UIGEA. Pay sites typically offer games with differing entry fee and prize levels. These differing stakes levels will appeal to the various tastes and desire for risk of the fantasy sport enthusiast. With regard to advertising, any revenue from that source is incremental to their primary revenue stream of entry fees paid by players. Of the pay-to-play sites surveyed and discussed below, third-party advertising was sparse, if appearing at all.

CBSsports.com

Similar to Yahoo and ESPN, CBS sports has a very complete and comprehensive fantasy sports presence. CBS offers extensive coverage of both straight sports news but also fantasy sports-focused news. In addition, like the other large fantasy sites, CBS provides free fantasy projections, trends and analysis.

CBS does offer free to enter fantasy games as well as the free short duration games that offer a singular overall top prize, similar to ESPN. Differentiating from Yahoo and ESPN, CBS has a definite focus on their pay-to-play premium games, where they are the market leader in that category. They offer a wide selection of entry fee/prizes, from as low as a \$39.99 entry/\$200 prize to a \$499.99 entry/\$3,500 prize. Only the winner of the 12 team league wins the prize, so the generic odds of winning are 1 in 12.

The gross margin of the games varies by the entry fee/prize structure, with a higher margin of 58% for the \$39.99 entry fee game to a lower margin of 41% for the \$499.99 entry fee game. CBS' pay-to-play premium games are the season-long games as opposed to the shorter time-span games that may only last a week (Cbssports.com, 2011).

Rtsports.com

RealTime fantasy sports focuses primarily on the pay-to-play games. Their website home page is very explicit regarding the various games and prize levels. They do offer a very

limited amount of content that is free. This content consists of a draft guide, mock player drafts and a message board discussing fantasy football topics. RealTime does partner with third parties that offer services such as player analysis, team draft analysis and assistance and in-season prognostication.

This site does offer a commissioner service for \$19.99, where a private league can have RealTime host their league online. This service would tend to keep people on the site and hopefully will incent them to enter the pay-to-play contests (Rtsports.com, 2011).

RealTime has a definite focus on CBS as its competition and has chosen its entry fee/prize structures to have a higher overall payer payout than CBS. RealTime also offers three entry fee tiers, with the lower fee game at a \$29.99 price point as opposed to CBS' \$39.99 entry fee. RealTime's mid and high entry fee games have the same entry fees as CBS (\$99.99 and \$499.99), but the overall amounts paid in prizes is higher, specifically trading gross margin in order to generate a higher player payback percentage. In addition, the \$99.99 entry fee game pays for first and second place; the \$499.99 entry fee game pays for first, second and third place. Like CBS, RealTime's games are structured to be season long in duration, but they do have a "faceoff" game where it is an 8 team league where it is a single-elimination tournament game (Rtsports.com, 2011).

Fanduel.com

This newer entrant is approaching the pay-to-play fantasy sports market with shorter duration games which last either a week or even just one day, with payouts occurring quickly. The entry fees for the games may be as low as \$5. Fanduel claims in its marketing of "\$10,000,000 in cash payouts in 2011," with "over \$20,000 in cash payouts every day" (Fanduel.com, 2011, Home page). In addition, they claim a 100% money back guarantee if a

customer loses their first \$5 or \$10 game and they are not satisfied. Fanduel also offers free play, but that is likely more of a learning and familiarization tool as their site appears devoid of third-party advertising.

Fanduel is definitely attacking the low end of the fantasy sports pay-to-play segment. Their quick games are more closely akin to traditional sports betting, where the time span between wager and payout is only a day or two. Unique aspects that Fanduel has implemented that other pay-to-play fantasy sites have not are the concepts of referral bonuses and reward points. The referral bonus is a modest \$10, but that \$10 will be applied to a \$10 entry fee game. The bonus is provided to both the new player and the referrer. With regard to reward points, they accrue during the month. Depending on how many points are accrued, they can qualify the player to enter a freeroll or free play contest with a payout that can vary from \$600 to \$2000. These aspects are similar marketing approaches to those employed by online gambling sites, even though Fanduel offers legal skill gaming products (Fanduel.com, 2011).

Online Racing Wagering

With regard to pari-mutuel wagering, horse race betting has been socially acceptable and legal in many jurisdictions in the US for decades. The annual large racing events, the Kentucky Derby, Preakness, Belmont Stakes and Breeders' Cup, attract television viewers and wagering activity, particularly internet wagering activity. With the passage of the Interstate Horse Racing Act of 1978 that expanded the ability to place an off-track wager, off-track wagering has become the dominant method of pari-mutuel wagering in the US. Approximately 90% of all pari-mutuel wagering or "handle" is off-track (JockeyClub.com, 2011).

What is pari-mutuel wagering? "Pari-mutuel or para-mutuel is a term derived from the French expression meaning 'a wager among ourselves.' It is a wagering method where all

bettors are competing for a common pool of funds. Bettor skills are pitted against one another rather than against the house” (Downes, 2005). Racing wagering in the US and Canada is currently performed using the pari-mutuel method of wagering. Pari-mutuel wagering differs from fixed odds wagering in that the house does not have to rely on its ability to divide the betting pool in order to avoid risk to its own capital. With pari-mutuel, the winners share the total amount wagered on an event minus a fixed commission for the house. “Another way of stating this is that pari-mutuel wagering is a form of betting in which the losers' wagers, less a percentage for the house, are distributed among the winners” (Downes, 2005).

“Unlike fixed odds wagering, with pari-mutuel wagering the house does not win money directly from the players, but rather only collects a commission on wagers. While the house will not win money directly from the bettors in this type of system, it will not lose money to the bettors. The house inherently has a far lower level of risk to its capital with pari-mutuel wagering than with fixed odds wagering. The reason this is so is that the house's flexibility in providing betting options is not limited by the need to divide the betting stakes into offsetting groups in order to hedge the house's risk to capital” (Downes, 2005).

As explained earlier, online pari-mutuel race wagering operates under a structure called Advanced Deposit Wagering (ADW). A prospective bettor must first register with the wagering entity, providing proof of ability to place wagers, and deposit funds in advance. The bettor then can via an online portal, make pari-mutuel wagers using the funds deposited in advance. Unlike fantasy sports contests, horse and dog racing ADWs offer bona fide online wagers.

ADWs are very similar with regard to structure. They register bettors, take bets and pay winning bets. In addition, ADWs generally offer some level of video feed to show the various tracks and races. Unlike professional sports, to see races one needs to have the video feed from

the appropriate track as the major television networks generally only cover the major racing events like the Triple Crown races and the Breeders Cup. Seeing the video feed from the track before the race allows the bettors to view the animals before the race, to help bettors determine the pre-race condition and demeanor of the animals before placing a wager.

To attract customers, ADWs will generally offer some level of sign-up bonus and a loyalty program. ADWs can compete with regard to which specific horse and dog tracks are covered by their platform. The major tracks are covered, but there are differences with regard to which minor horse tracks and dog tracks the ADW services.

Although ADWs are basically alike, there is a big difference between the ownership of the ADW – those operated by racetrack companies and those that are standalone entities. Churchill Downs and Magna Entertainment, owners of several racetracks in the US and Canada, operate their own ADWs. An example of a standalone ADW is Premier Turf Club. The advantage of a racetrack owner vertically integrating is the advantage of being able to offer additional rebates and incentives for wagers on owned tracks (XpressBet.com, 2011; Twinpires.com, 2011; Betptc.com, 2011).

Strategy and Positioning

Harvard professor Michael Porter is a recognized expert with regard to strategy and positioning. Porter states, “positioning – once the heart of strategy – is rejected as too static for today’s dynamic markets and changing technologies. According to the new dogma, rivals can quickly copy any market position, and competitive advantage is, at best, temporary” (Porter, 2011). He then disagrees with that dogma and clarifies the cause of this erroneous view with the position that the root of the problem is the failure to distinguish between operational effectiveness and strategy. Not that operational excellence is unimportant, far from it. However,

just doing things right may not be enough. It is important to do the right things right. Porter re-again asserts his theory on positioning and competition. That is, “a company can outperform rivals only if it can establish a difference that it can preserve” (Porter, 2011).

The key to strategy, according to Porter, is achieving sustainable competitive advantage. “Strategy is the creation of a unique and valuable position, involving a different set of activities” (Porter, 2011). This reflects back on his identification of three thrusts that can be pursued by a firm in a competitive industry: unique offering, niche market or low cost producer (Porter, 2011).

Focusing on new offerings, Rafii and Kampas (Rafii & Kampas, 2002) disclose a tool based upon the way disruptive innovations invade established markets. This tool, which they call a disruptiveness profile, numerically rates a potential disruptive threat according to the six stage process that disruptions take:

- Foothold market entry,
- Main market entry,
- Customer attraction,
- Customer switching,
- Incumbent retaliation, and
- Incumbent switching (Rafii & Kampas, 2002).

The tool, although designed for companies evaluating inbound threats, can just as easily be applied to insurgents looking to invade existing markets. New offerings identified by the competitive landscape can be put through the disruptiveness profile to estimate their potential for success.

With respect to the ADW marketplace, it appears at first glance that a unique offering or niche market approach is not feasible, as the current crop of competitors can serve all niches and can emulate an offering. In addition, the ADWs operated by Magna Entertainment and Churchill Downs are part of those companies' portfolio which include racetracks, further limiting the potential of a differentiated offering. Currently, the patented concept of pari-mutuel fantasy sports wagering is a potential, but as discussed earlier, certain federal statutes would have to be modified in order to commercially offer those types of wagers (Downes, 2005). The only approach appearing to be a current option is the option of being the low cost producer. Given that ADWs have certain costs in common, the cost elements under the full control of the ADW need to be conspicuously frugal, yet sufficient in terms of quality, scale and customer satisfaction.

With respect to the fantasy sport skill game marketplace, competitors typically craft their games across the following dimensions: stakes/prizes, player selection, scoring methodology, competition method, and timeframe (Downes, 2008). Further explanation of the various dimensions is discussed below.

Entry fees for fantasy sports games can vary from free to several thousand dollars. The resulting prizes tend to vary proportionately with the level of the entry fee – the lower the entry fee, the lower the prizes. Prizes can vary from free to several hundred thousand dollars. Even as operated as a skill game, fantasy sports contests have the potential to deliver life-changing prize payouts. As stated earlier, fantasy sports games fall under an exception in the UIGEA if they are operated within the safe harbor parameters.

Signore discussed fantasy football in great detail, including the various types of fantasy football games (Signore, 2007). There are several methods by which fantasy sports players craft

their virtual teams. The most common methods are draft, salary cap and auction. Each method has benefits and constraints, which can appeal to the desired tastes of the fantasy sport enthusiast. Although Signore focused on fantasy football, the various methods of team selection are common to fantasy games based on other sports or events.

In a draft, players take turns choosing real-world players for their teams. In this method, real-world players are mutually exclusive in that if a particular real-world player is chosen for a fantasy team, that real-world player cannot be chosen for another team. Drafts are typically done in a “serpentine” fashion. That means that if a team selects first in a particular round of selection, that team will select last in the next round of selection. For example, in a 12-team serpentine draft, the team that selects the first player in round 1 will select the last player in round 2 and then the first player in round 3, continuing until the end of the draft. Similarly, the player that selects last in round 1 will select first in round 2.

In a salary cap fantasy game, real-world players are assigned various fictitious salaries. Each fantasy team must in aggregate be composed of players whose salaries fall within a predetermined cap, as outlined in the game’s rules. In this type of selection method, a real-world player can be selected by multiple teams. The constraint on the salary cap game is that the better players have higher salary levels, such that a team will not have the ability to have a team filled with the most accomplished real-world players and still stay within the salary cap constraint.

In an auction, fantasy teams are assembled by teams bidding on the particular real-world players. Teams are given a total salary, similar to a salary cap, but the salary of the various real-world players are set by the highest bid from the various fantasy sports teams. Like the salary cap game, the aggregate team salary must fit within the pre-determined salary constraint. Similar

to the serpentine draft game, if a player is selected for one team, they cannot be selected by another, unlike the salary cap fantasy game.

Scoring methodology is another means of differentiating games. Which real-world performance metrics are used and how they are weighted result in variances in real-world players' fantasy value. This dimension has great impact with regard to how fantasy sports enthusiasts value particular players and rank them for purposes of selection.

The method by which a fantasy sports player wins games or even their league does vary. One method is called a rotisserie method, where all teams accumulate points during a period of time, with the highest scoring team winning. Another method is head-to-head, where selected teams "play" each other according to a pre-determined schedule, usually with a playoff scheme in the last couple of weeks of that fantasy game season, where the ultimate winner is determined. The playoff method can also be used throughout, where the fantasy season from start to finish can be just a few weeks as teams are eliminated in each round of play.

The timeframe of fantasy games can vary widely. Some can be as short as one day. Typically the timeframe of a fantasy sports game is close to the length of the regular season for the various real-world sport leagues. The games do not generally extend into the post-season as the number of real-world players whose actual teams make the post-season is limited. For fantasy sports purposes, the last portion of the sport league regular season is typically the fantasy sport playoff/post-season.

Fantasy sports sites craft offers that vary one or more of these dimensions. None of these dimensions creates a sustainable competitive advantage because any competitor has the potential to emulate the exact same game offer. The patent covering pari-mutuel wagering on fantasy sports, due to the inherent exclusive nature of that kind of intellectual property, can convey a

sustainable competitive advantage as other fantasy sports firms will not be allowed to craft a similar offer during the effective term of the patent (Downes, 2005).

Conclusion

Multiple sources were consulted to capture the breadth and depth of the various topics relevant to this study, with only publicly releasable information discussed. The literature review began by describing what fantasy sports are and then stated the primary animal racing sports in the United States. Key Federal laws that set the general boundaries for online wagering were presented. Finally, detail on typical online fantasy sports and racing wagering websites are introduced, along with additional detail on how sites even in the same game genre differ.

Fantasy sports is a type of game where participants select a number of real-world sports or event participants to craft a virtual team, which certain performance statistics or metrics are accumulated and compared with similar metrics from competing virtual teams to determine game outcomes. Currently approximately 30 million Americans play fantasy sports (Walker & Lee, 2007).

Racing is the only sport which can offer online interstate wagers in the United States, due to the restrictions of the Wire Act (Law.Cornell.edu, 2011d). The dominant racing sport is horseracing, with both thoroughbred and standardbred (harness) racing available in many states. To a much lesser extent, dog racing (greyhound) is also available. The allowed wagering methodology for racing is the pari-mutuel wagering method, as opposed to fixed-odds wagering, which is commonly used for other sports betting. The racing industry in the United States has been undergoing a slow but steady decline for several years (JockeyClub.com, 2011).

In general interstate wagering on sports events is forbidden by the Wire Act, and supplemented by the Unlawful Internet Gambling Enforcement Act (UIGEA) and the

Professional and Amateur Sports Protection Act (PASPA) (Law.Cornell.edu, 2011c). In addition, there is a key case holding that cements the finding that player names and performance statistics are public domain, covered by First Amendment protections.

Fantasy sports contests have great variability with regard to game structure, prize structure, length of game and number of allowed contest participants. Fantasy sports websites can offer either free play or pay-to-play games. The pay-to-play games must operate in accordance with the restrictions outlined in the UIGEA (Downes, 2007).

Online pari-mutuel race wagering operates under a structure called Advanced Deposit Wagering (ADW). A prospective bettor must first register with the wagering entity, providing proof of ability to place wagers, and deposit funds in advance. Unlike fantasy sports contests, horse and dog racing ADWs can offer bona fide online wagers.

Strategy and positioning are crucial to inserting successfully in any new endeavor, particularly in an industry with established competitors. The key to strategy, according to Porter, is achieving sustainable competitive advantage. “A company can outperform rivals only if it can establish a difference that it can preserve” (Porter, 2011).

“Strategy is the creation of a unique and valuable position, involving a different set of activities.” This reflects back on Porter’s identification of three thrusts that can be pursued by a firm in a competitive industry: unique offering, niche market or low cost producer (Porter, 2011).

Focusing on new offerings, Rafii and Kampas (Rafii & Kampas, 2002) disclose a tool based upon the way disruptive innovations invade established markets. This tool, a disruptiveness profile, numerically rates a potential disruptive threat according to the six stage process that disruptions take. The tool can also be applied to insurgents looking to invade

existing markets. New offerings identified by the competitive landscape can be put through the disruptiveness profile to estimate their potential for success (Rafii & Kampas, 2002).

With regard to positioning in the fantasy sports skill game market, the patent covering pari-mutuel wagering on fantasy sports, due to the inherent exclusive nature of that kind of intellectual property, can convey a sustainable competitive advantage as other fantasy sports firms will not be allowed to craft a similar offer during the effective term of the patent (Downes, 2005).

With respect to the ADW marketplace, it appears at first glance that a unique offering or niche market approach is not feasible, as the current crop of competitors can serve all niches and can emulate an offering. In addition, the ADWs operated by Magna Entertainment and Churchill Downs are part of those companies' portfolio which include racetracks, further limiting the potential of a differentiated offering. However, the patented concept of pari-mutuel fantasy sports wagering is a potential, but as discussed earlier certain federal statutes would have to be modified in order to commercially offer those types of wagers (Downes, 2005; Law.Cornell.edu, 2011a; Law.Cornell.edu, 2011b; Law.Cornell.edu, 2011c; Law.Cornell.edu, 2011d). The only approach appearing to be a current potential ADW option is the positioning of low cost producer.

Part Three

Introduction

This section concludes the paper, taking the results of the literature review and synthesizes them into differentiated potential offerings. In addition, additional questions for further research of areas covered by the literature review and new questions to be explored based on these results given.

Results

From the literature, there are a couple of proposed offerings that are differentiated from current offerings. The proposed offerings will be aligned under the two gaming areas covered in the literature review, fantasy sports and animal racing. The fantasy sport potential offering is a skill game and the animal racing potential offering is a regulated wagering game, even if the specific pari-mutuel implementation is fantasy sport-based, due to the wagering aspect.

Fantasy Sports

All current fantasy sports iGaming offerings now existing are operated as skill games that fall under the UIGEA safe harbor provisions. Games are offered in both free play and pay-to-play formats, with prizes varying from free to the hundreds of thousands of dollars. There are two areas where no fantasy sport offering exists. The first area is an extension of the UIGEA safe harbor in that there is no fantasy sports game that operates in a regulated wagering fashion. The second area where no fantasy sport offering exists is that there are no fantasy sport offerings that incorporate pari-mutuel wagering principles. Accordingly, a pari-mutuel fantasy sport iGaming offering can be crafted in both a skill game and a regulated wagering mode. The regulated wagering mode will be discussed further in the subsequent section.

As a skill game, the pari-mutuel wagering method can be used as a new way of selecting a fantasy team as well as a new type of scoring methodology. To fall under the UIGEA safe harbor, a team of multiple players must be crafted. Game participants can use virtual currency or game units to make selections of the players they desire on their team, placing virtual pari-mutuel bets on their desired players. The odds or rewards that a particular real-world player would offer if they finished in the money will be inversely proportional to the game units “wagered.” This selection method will allow for the crafting of teams much faster than traditional fantasy drafts and is very amenable to large pools of game participants, which could generate significant entry fees, and therefore allow the iGaming operator to offer large prizes.

This method can be insulated from competitor emulation due to the concept of pari-mutuel sport wagering being protected by patent. To stay within the UIGEA safe harbor, the game offering must exchange the entry fee for the same fixed amount of virtual currency for each entry, which then is used to make pari-mutuel wagers and receive payouts in the virtual currency. How game participants prevail in the contest is to win the most virtual currency during the game, with various prize amounts awarded.

Animal Racing

ADWs offer the same basic wagering portal. The differences will generally revolve around pricing, which can be replicated or matched by the other competitors. ADWs that are owned by racetracks may have the ability to offer takeout rates or bet rebates on races carried by their owned tracks. The most logical option for a new entrant ADW would be as a no-frills, high rebate competitor. However, the operational excellence would have to be high in order to survive on thin margins.

The best potential regulated wagering iGaming offering would be pari-mutuel wagering in a fantasy sport context. This would entail typical pari-mutuel wagers associated with horse and dog racing (e.g., win, place, show, exacta) applied to performance statistics of real-world professional sport athletes. This would be a completely new offering, but due to the regulated wagering and iGaming aspects, would require changes to various statutes at the federal and state level. This offering, due to patent protection, would be insulated from competitor retaliation during the term of the patent, giving the new entrant a defensible market position.

Conclusions

The fantasy sports consumer demographic is lucrative and the fantasy sports industry is not nascent. Fantasy sports consumers are heavily weighted toward the US and Canada (approximately 30 million), with males being the predominant participants (70%) (Walker & Lee, 2007; Amic, 2011).

Overall, the direct market size of the fantasy sports industry is estimated at \$800 million, with a total market impact of \$4.48 billion (Amic, 2008). The fantasy sports consumer is valuable, even in this current economic climate.

The fantasy sports industry is large, but not consolidated. There are some large players, but almost half of the fantasy sports consumers participate in offerings that are not provided by the top four competitors (Amic, 2008; Fantasysportsbusiness.com, 2010). The industry is maturing, but is not saturated.

Animal racing is the only sport which can offer online interstate wagers (pari-mutuel) in the United States, due to the restrictions of the Wire Act (Law.Cornell.edu, 2011d). The racing industry in the United States has been undergoing a slow but steady decline for years, with

wagering handle in 2010-level dollars declining 37% since 2003 and declining 49% since 1975 (Lamb & Singer, 2011).

The industry has made attempts to restore its health. The first effort was the passage of the Interstate Horse Racing Act in 1978 to allow off-track (also known as simulcast) wagers and its amendment in 2000 to allow wagering on races over the internet. The second effort was the insertion of slot machine parlors at racetracks, with slot revenues used to augment racing.

Even with these efforts, the projected future is not promising. The average age of horse racing fans is 51, expected to increase to 57 by 2020 (Lamb & Singer, 2011). The estimates for various metrics for horse racing in 2020 are: wagering handle down by 25%, foal crop (baby horses) down by 9%, number of racetracks down by 27%, state revenue down by 25%, and horse owners' losses up by 50% (Lamb & Singer, 2011).

There are a few key cases that lay the framework with regard to the legal basis for online pari-mutuel wagering and online fantasy sports contests. In general interstate wagering on sports events is forbidden by the Wire Act, and supplemented by the Unlawful Internet Gambling Enforcement Act (UIGEA) and the Professional and Amateur Sports Protection Act (PASPA) (Law.Cornell.edu, 2011b; Law.Cornell.edu, 2011c; Law.Cornell.edu, 2011d). In addition, there is a key case holding that cements the finding that player names and performance statistics are public domain, covered by First Amendment protections (Associated Press, 2008).

Focusing on the US, the legal areas that impact fantasy sports are gaming law and intellectual property law. Both state and federal law cover gaming. Each state has the ability to determine what level of gaming is allowed within the state, and what constitutes gambling. What may be considered a contest in one state may be viewed as prohibited gambling in another.

Positioning, particularly in a competitive environment, is crucial. Harvard professor Michael Porter states, “A company can outperform rivals only if it can establish a difference that it can preserve” (Porter, 2011). The key to strategy, according to Porter, is achieving sustainable competitive advantage. “Strategy is the creation of a unique and valuable position, involving a different set of activities” (Porter, 2011). This reflects back on his identification of three thrusts that can be pursued by a firm in a competitive industry: unique offering, niche market or low cost producer (Porter, 2011).

Rafii and Kampas disclose a tool based upon the way disruptive innovations invade established markets. This tool, a disruptiveness profile, numerically rates a potential disruptive threat according to the six stage process that disruptions take (Rafii & Kampas, 2002). The tool can be applied to insurgents looking to invade existing markets to estimate their potential for success.

Upon review and findings of the literature, pari-mutuel based fantasy sport offerings are new, differentiated offerings that have the power of patent protection to establish and maintain a defensible position in the US iGaming marketplace. These offerings can be technologically deployed either in a skill game or true pari-mutuel wagering mode. With regard to economics, the size of the current fantasy sport and animal racing industries are conducive to the addition of these new offerings.

The new fantasy sport skill game offering can be implemented without any changes in current law, so that potential offering should be the first one further examined with regard to commercial implementation. The regulated wagering pari-mutuel offering cannot at this time be commercially implemented without changes to state and federal law.

Recommendations

The next steps for the fantasy sport/skill game iGaming offering should be to determine what types of games should be offered and to determine the specifics of how each of the games would be played, in order to calculate a profitable entry fee/prize structure for each type of game. After that, the required pari-mutuel and website partners required for implementing the potential games need to be identified, non-disclosure agreements executed and detailed business and technical discussions started. Further economic and business model feasibility can be explored once these prerequisite questions have been answered.

The next steps for the regulated wagering iGaming offering should be to keep abreast of developments in New Jersey's efforts to implement sports betting in that state and its challenge to the constitutionality of PASPA. In addition, as the fantasy/skill game iGaming offering is being developed, socialization of the potential for expanded pari-mutuel wagering can begin with the racing regulatory bodies of the large horse racing states, such as California, New York, Kentucky and Florida, as well as New Jersey.

To take advantage of the current legal landscape, socialization of the concept implemented in a non-online fashion should be started with casino operators in Nevada, where sport betting is currently allowed. Depending on interest from the Nevada casino operators, exploration of the regulatory certification process for pari-mutuel wagering games could be initiated in order to estimate the time and expense required for approval.

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