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Ms. Wanda Wilson
Tennessee Education Lottery Corporation
26 Century Blvd., Suite 200
Nashville, Tennessee 37214

***In re: Comments on Draft Sports Gaming License Rules, Regulations and Standards***

Dear Ms. Wilson:

Pursuant to your invitation, I write to comment on the Draft Sports Gaming License Rules, Regulations, and Standards ("Draft Rules") that your office circulated to the Tennessee Education Lottery Corporation Sports Wagering Advisory Council (the "Council") on November 21, 2019, and to members of the public on November 22, 2019. It is an honor to serve on the Council and to participate in the process of shaping sports gaming in Tennessee in a successful, transparent, and responsible manner.

I write aware that you asked members of the Council, as well as members of the public, to comment on the Draft Rules by filling out a section-by-section form on the Tennessee Education Lottery Corporation ("TELC" or the "Corporation") website. With apologies, my comments take a different form for three reasons.

First, a narrative is most consistent with the statutory purposes of the Council to "advise the board of best practices with respect to sports wagering" and to "[p]rovide administrative and technical assistance to the corporation with respect to sports wagering." Tenn. Code Ann. § 4-51-305(n). The statute authorizes the Council—not individual members—to advise TELC, and it is my hope a longer narrative shared in the spirit of openness and complete transparency with all Council members will encourage deliberation and engagement at our next meeting to the benefit of TELC. Second, my comments attempt to engage the Draft Rules' interplay with provisions of the Tennessee Sports Gaming Act, Tenn. Code Ann. 4-51-301 et al. (the "Act"), urging a longer-form style. Finally, in addition to providing comment, this format is more conducive to raising questions for future study and consideration.

**Business plan.** As a preliminary matter, it is difficult to comment upon the Draft Rules, and "to advise the Board of best practices with respect to sports wagering" without visibility into the business plan the Draft Rules are intended to support. It is not unlike approving plans for construction of a vehicle without knowing whether the vehicle is intended to haul gravel or transport the family to school.

To be clear, the authorizing language of the Act is broad, and conveys the task of implementing sports gaming in Tennessee to TELC. As the experience of other states

demonstrates, however, there are many means of implementing a sports gaming industry. New Jersey has multiple online licensees, in addition to a long-standing casino and sports book business. New Hampshire recently announced it would roll out its mobile sports wagering with a single licensee. Some states hold licenses themselves, and permit retail outlets to participate as vendors under the license, employing geo-fencing and ID checks at the door to protect against minor wagering.

It is not for the Council to determine the business model. It is, however, for the Council to advise TELC with respect to all aspects of sports gaming, and we cannot do that well without a robust discussion of the Corporation's intended business model. As Tennessee's open records laws do not appear to apply to the licensee application and evaluation process—an unfortunate result, in my judgment—there is no other means by which the Council's advice and counsel may be most closely tailored to TELC's needs, and the public assured that sports gaming licenses have been issued, and applications evaluated, in accord with Tennesseans' expectations for this new industry.

**Capped Payout.** The Draft Rules artificially cap payouts at 85% of a Sports Gaming Operator's handle. Draft Rule 15.1.11. The proposed payout cap seems arbitrarily drawn out of context with the sports gaming industry in America and is, therefore, is worthy of vigorous discussion.

Draft Rule 15.1.11 will hurt players. Less money paid to players means smaller prize pools. Smaller prize pools means players will migrate to other states' platforms or stay with unregulated offshore betting services. Because Tennessee's sports gaming is mobile only, Tennessee operators cannot pair lodging, meals, and entertainment options with gaming opportunities, as at a casino. This means the handle is dependent on pure gaming only. This means the cap hurts Tennessee, and the scholarships, infrastructure, and mental health programs the Act intends to fund.

| JURISDICTION | 2019 Handle | % of 2019 handle paid out to players |
|---|---|---|
| **Oregon** | $5,603,000 | 96.1% |
| **Nevada** | $7,155,078,431 | 93.6% |
| **Rhode Island** | $196,446,635 | 93.1% |
| **New Jersey** | $4,709,744,166 | 93.0% |
| **Pennsylvania** | $848,726,134 | 91.0% |
| **West Virginia** | $209,142,308 | 89.9% |
| **Mississippi** | $420,867,776 | 87.6% |
| **Delaware** | $166,028,392 | 87.3% |
| **Iowa** | $93,605,610 | 86.4% |
| **Tennessee** | N/A | 85% (proposed) |
| **Indiana** | $126,912,809 | 84.2% |

| | | |
|---|---|---|
| **TOTAL**[1] | $13,932,155,260 | 7.2% |

As the above table makes clear, the proposed 85% payout cap is significantly lower than that of nearly other state offering sports gaming.

This brings us back to the business model discussion. Note, for example, in New Hampshire, which awarded a single license to Draft Kings this summer for retail and mobile sports gaming, the licensee is paying 51 percent of all its revenues to the state in a unique deal in which the state's share goes down as it authorizes competition in the marketplace.

As presently structured, however, the Draft Rules allow licensees to keep more money in profits than virtually every other state—and pay less to Tennesseans in winnings. While a low payout cap increases AGI, presumably increasing privilege tax revenue, the better way to increase revenue, as well as jobs and the success of the business, would be to grow the handle.

**Levels of licenses.** The regulatory structure also should be discussed in light of the business plan. It seems unwieldy and unworkable to require three classes of licenses, particularly for Class III licensees who, by the terms of Draft Rule 15.1.4.A.3 are merely vendors providing "services that are not material…to the conducting of [sic] on-line interactive Sports Pool."

The definition of a "license" in the Act also appears to be in conflict with the regulatory scheme envisioned by the Draft Rules. Under the Act, "license" is defined to mean "a license to accept wagers on sporting events." Tenn. Code Ann. § 4-51-302(12); see also Draft Rule 15.1.2.U (defining "license" as "the authority to engage in sports gaming operations granted by the TELC pursuant to the Sports Gaming Act." Despite the definitional limits of the Act and Draft Rule 15.1.2.U, however, the Draft Rules in section 15.1.4 imagine a much wider class of persons who must obtain licenses, including many entities and individuals who will not "accept wagers on sporting events" or "engage in sports gaming operations."

Licensure has serious implications under the Act. A licensee "under this [Act] is subject to all provisions of this [Act] relating to licensure, regulation, and civil and criminal penalties." Tenn. Code Ann. § 4-51-303. As set forth in the Act, that includes audits, id. at 4-51-310(2); scrutiny of their financial and operational practices, id. at § 4-51-310(1); periodic financial reporting, id. at 4-51-310(3); prohibitions against wagering, id. at § 4-51-312(a)(1); mandatory disclosure of disciplinary proceedings "in connection with its operations," id. at § 4-51-315(b)(1); consent to inspection of premises and records by TELC staff and board members, id. at § 4-51-313; and investigations by TELC, including the board's subpoena power in pursuit of such investigations, id. at § 4-51-326; and potential civil and criminal penalties, see, e.g., id. at § 4-51-327.

Public policy should favor limited intrusion into private lives and enterprises where the services they provide are not core to accepting wagers on sporting events, and therefore the concerns for systemic integrity, of the Class I licensees. The regulatory scheme under the Draft Rules does the opposite.

[1] Source: US Sports Betting Revenue & Handle, Legal Sports Report (through Dec. 9, 2019). Three of the above states commenced sports gaming in 2019: Iowa in August; Indiana in September; and Oregon in October. All other above states have had sports gaming throughout 2019.

Numerous questions arise, among them: does the TELC have the staff to review and regulate these licenses, which could number in the dozens, especially at the Class III level? Are Class II and Class III licenses subject to the Act's 20% privilege tax? Tenn. Code Ann. § 4-51-304 says all licensees under the Act are subject to the tax. Are all licensees equally responsible, as the Act appears to state, for preventing minors from wagering in Tennessee, an offense that carries serious criminal and civil penalties.

The proposed license structure deserves a thorough hearing at the Council's next meeting so that we can get the answers to these and other questions before determining whether this regulatory structure best suits the needs of the State.

**Definitions.**

*Cancelled wager.* The definition at 15.1.2.I says a cancelled wager is one that "has been cancelled by the system," without appearing to define elsewhere in the Draft Rules what is meant by "the system."

*Global risk management.* I understand the purpose of global risk management as defined in Draft Rule 15.1.2.O, but I do not understand the intent of this language: "The TEL shall be provided with information regarding an intent to utilize global risk management including the written agreement of those services. The TEL may reject the use of such services for any reason deemed reasonable in the preservation of the integrity of the Sports Gaming Act." These sentences require unpacking. My questions include: Are there any potential Class I or II licensees who do not utilize global risk management and, if not, then the two sentences at the end of this section would appear to swallow up the entire licensee selection process. Finally, the integrity of the Act itself would be at issue with respect to a global risk management system, but rather the business model and the execution of same. If this aspect of the business is as critical as the language quoted above makes it appear, then perhaps there need to be clearer standards incorporated into 15.1.2.O.

*Fantasy sports.* The Act does not refer to fantasy sports, which are regulated pursuant to the Fantasy Sports Act, Tenn. Code Ann. § 48-18-1601, et seq., by the Secretary of State. Given the previous opinion of the Tennessee Attorney General that fantasy sports constitute gambling under Tennessee law, there may be value in clarifying the definitions of "wager" or "bet" in Draft Rule 15.1.2.YY to specifically exclude fantasy sports.

*Strong authentication.* The subjective modifier "that has been demonstrated to the satisfaction of the TEL" in Draft Rule 15.1.2.QQ swallows up the objective terms. Suggest deleting the subjective modifier.

**General rules.**

*Location of Sports Gaming System.* Draft rule 15.1.3.E requires "placement and operation of the Sports Gaming System" in Tennessee. "Sports gaming system" is not otherwise defined in the Draft Rules. What is it, why should it be located in Tennessee—indeed, can it be located within Tennessee within the use of a global risk management system—and is this a requirement that would favor one potential licensee or business model over another?

*Impermissible wagers.* The Act and the Draft Rules prohibit prop bets on intercollegiate sports. Draft Rule 15.1.3.H.2, however, defines an impermissible collegiate prop bet to include "the performance or non-performance of a team or individual participant during a collegiate

sporting event." As wagers on the outcome of intercollegiate contests are allowed, suggest deleting the phrase "a team or" and inserting in its place the word "an." Further, the prohibition of wagers in Draft Rule 15.1.3.H.5 upon "an occurrence determinable by one person or one play" requires further refinement. Many sports plays are such plays, e.g., a home run, free throw, field goal.

*Post-mservice restrictions.* Suggest this period be extended from one to two year and the prohibition extended to include employment by any licensee.

*Standards of review*. There are times when the rules appear to grant TELC complete discretion to determine a licensee's qualifications (see the definition of global risk management, discussed above), and then there are other times, such as Draft Rule 15.1.5.D.20 (requiring "clear and convincing evidence" of a licensee's "competency, law abiding nature, suitability, honesty and integrity"). Consistency and clarity, especially in matters of licensure review, are an important values for the rules to embrace.

**Approval or denial of an application.**

*Who may not apply.* Suggest adding elected officials to Draft Rule 15.1.7.A.1.

Draft Rule 15.1.7.B.26 prohibits any individual convicted of a crime in the past 10 years involving "intoxicated liquors" from applying for a license. Would this include persons convicted of misdemeanors, such as driving under the influence or public intoxication?

Draft Rule 15.1.7.D.13 requires TELC to consider whether an applicant "is or has been a defendant in litigation involving its business practices that would call into question its suitability to be licensed." Having defended many persons and businesses who have been sued, this seems a poor measure by which to determine one's fitness for licensure. Persons who should not be sued are sued all the time.

**Maintenance of License.**

*Audits.* Level I licensees appear by the rules (see above re: statutory audit requirements) to be subject to audit by both the TELC and certified public accountants. Draft Rule 15.1.8.C. Are both necessary. Is there a difference in the nature of the audits? Is the Comptroller of the Currency the appropriate office to conduct and/or file these audits?

*Required bank accounts*. I suggest amending Draft Rule 15.1.8.E to require Class I licensees to maintain appropriately segregated bank and escrow accounts in Tennessee, and not merely with "financial institution(s) licensed to conduct business in Tennessee."

*Payment of privilege tax.* Draft Rule 15.1.8.F should be omitted. The General Assembly sets privilege tax rates, not the sports gaming rules.

*Advertisements.* I am concerned about the TELC staff's capacity to review and comment on the content of all sports gaming operators' proposed advertisements. I also have grave concerns about much of the content-based limitations on speech proposed in Draft Rule 15.1.8.L. The Council should engage the particulars of this Draft Rule with care after full discussion.

**Rules Governing Sports Wagering Accounts.** Draft Rule 15.1.10.B.2 provides, "Licensees shall have in place technical and operational measures to prevent sports wagering by those who are underage." Given that all sports wagering in Tennessee will occur online, and much of that on hand-held devices, I cannot imagine what "technical and operational measure" a licensee

could put in place to keep a minor from placing a bet, with or without the consent of a person over the age of 21. I share the concern expressed at our November 2019 Council meeting regarding the ability of licensees to prohibit minors from placing sports gambling wagers. This is another area where it is important to understand the TELC's proposed business plan, as other states have implemented on-the-ground means of ensuring licensee compliance with the under-21 prohibition.

**Transparency.** Finally, I urge the Council and the TELC to engage in a robust and open dialogue toward creation of the most transparent and citizen-friendly process for the rollout and regulation of this new industry. Citizen comments on the Draft Rules should be publicly available. Meetings of the Council should be open. Further, regardless of whether the Open Meetings laws technically apply to the Council, we should conduct ourselves as though they do. Tennesseans have a right to know who is commenting on these rules, and what they have to say (equally informative and important, perhaps, who is *not* commenting). Meeting agendas should be distributed to members and published to the public with sufficient notice. Minutes should be recorded and made publicly available. Copies of policies referenced in the Draft Rules, likewise, should be publicly available and distributed to members of the Council in a timely manner.[2]

As we move forward, I encourage all of us to adopt processes that increase public confidence in this very public endeavor beyond the meetings of the Council. Citizens have a right to know who is seeking licensure, and the terms of any license agreement with the TELC. There should be means of legislative and public accountability, and stringent ethics requirements for all persons participating in the process.

As important as the substantive program is to Tennessee, equally important is the process by which the Act is translated into a successful, open, and transparent industry.

**Conclusion.**

Thank you for your consideration of these comments. I look forward to working with you and your colleagues at TELC, as well as with the entire Council in the coming weeks, months, and years. Until then, I remain,

Very truly yours,

Thomas H. Lee

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[2] Draft Rule 15.1.7.I references policies drafted as Part 15.3, but no such procedures have been made available to the Council. Draft Rule 15.1.14.A.3 references "Dispute Resolution Regulations, Policy 15.2"—and assigns the Council a role in enforcing same—but no copy of the proposed dispute resolution regulations has been provided to the Council.