Private Prediction Markets’ Legality Under U.S. Law

by

Tom W. Bell

Professor,
Chapman University School of Law

www.tomwbell.com

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# I.A Legal Models: Distinguishing Means

## Introduction

I. Legal Models

## I. Legal Models

<table>
<thead>
<tr>
<th>Type:</th>
<th>Feature:</th>
<th>Skill-based Trading</th>
<th>Spot Trading</th>
<th>Zero-Sum Trading</th>
<th>Underlying Assets</th>
<th>Risk of Loss Greater than Investment</th>
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</thead>
<tbody>
<tr>
<td>Prediction Market</td>
<td>yes</td>
<td>yes</td>
<td>usually</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Futures Market</td>
<td>yes</td>
<td>no</td>
<td>yes</td>
<td>usually</td>
<td>yes</td>
<td>yes</td>
</tr>
<tr>
<td>Securities Market</td>
<td>yes</td>
<td>usually</td>
<td>no</td>
<td>usually</td>
<td>sometimes</td>
<td>sometimes</td>
</tr>
<tr>
<td>Gambling Market</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
<td>no</td>
<td>sometimes</td>
<td>sometimes</td>
</tr>
</tbody>
</table>

**Market Type v. Market Feature**
I.B. Legal Models: Distinguishing Ends

<table>
<thead>
<tr>
<th>Type:</th>
<th>Purpose:</th>
<th>Express Prices</th>
<th>Promote Discovery</th>
<th>Entertain</th>
<th>Hedge Risks</th>
<th>Raise Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prediction Market</td>
<td>primary</td>
<td>secondary</td>
<td>tertiary</td>
<td>tertiary?</td>
<td>N.A.</td>
<td></td>
</tr>
<tr>
<td>Futures Market</td>
<td>secondary</td>
<td>tertiary?</td>
<td>N.A.</td>
<td>primary</td>
<td>N.A.</td>
<td></td>
</tr>
<tr>
<td>Securities Market</td>
<td>secondary</td>
<td>tertiary?</td>
<td>N.A.</td>
<td>tertiary</td>
<td>primary</td>
<td></td>
</tr>
<tr>
<td>Gambling Market</td>
<td>N.A.</td>
<td>N.A.</td>
<td>primary</td>
<td>N.A.</td>
<td>N.A.</td>
<td></td>
</tr>
</tbody>
</table>

Market Type v. Market Purpose, Ranked by Importance
II. Legal Threats

A. Anti-Gambling Regulations

B. CFTC Regulations

C. SEC Regulations
   1. Because claims constitute securities
   2. Because PM could facilitate insider trading
      a. Liability for employees and employer
      b. One cure: Limit market to management
      c. Another cure: Publicize market results
      d. Notably, play-money offers no cure.
III. Legal Solutions

A. Dodge “Gambling” Label and Either:
   1. Keep in-house;
   2. Hire independent contractor researchers on commission; or
   3. Follow PurePlay’s (patented) business model.

B. Go Hedgestreet: CFTC-Regulated Retail Market
   1. Designated contract market
   2. Also a derivatives clearing organization
   3. Legal compliance costs = $400,000?

C. Win Legislative Cover

D. Risk Setting A Precedent
   1. An E-Bay in conditional negotiable notes(?)
   2. Professional games of skill
Conclusion

A. So far, so good.

B. But don’t ignore the legal risks of in-house prediction markets.

C. That legal uncertainty, while unfortunate, reflects the generally unsettled treatment of prediction markets under U.S. law.