INSIDER BETTING: DEEP THREAT OR NO HARM, NO FOUL

Greg Brower

Greg Brower & Mark Starr
Brownstein Hyatt Farber Schreck

With last year's U.S. Supreme Court decision in Murphy v. National Collegiate Athletic Association declaring the Professional and Amateur Sports Protection Act ("PASPA") unconstitutional, several states have rushed into the legal sports wagering market. Indeed, some experts estimate that within the next five years, at least 40 states will have legal sports betting in one form or another. While wagering on the outcome of sporting events is obviously not new, the proliferation of legal sports betting in the United States is unprecedented. As with anything new, the rise of legal sports betting has not occurred without a some considerable scrutiny. Some industry opponents and advocates alike have raised concerns about the impact this trend could have not only on the integrity of the underlying sporting events, but on the integrity of sports wagers themselves. One specific concern that some lawmakers and regulators have raised centers around the potential for certain bettors to use "confidential," "nonpublic," or "inside" information to gain an unfair advantage when a wager.

The scenario often referenced as an apt example of the supposed danger of insider information influencing sports wagering occurred during the 2018 NBA Finals. According to post-season news reports, then-Cleveland Cavaliers star LeBron James, frustrated by his team's loss to the Golden State Warriors in Game One of the series, punched a white board in his team's

<< At the time of PASPA's adoption in 1992, only four states—Nevada, Oregon, Montana and Delaware—allowed some form of sports betting. PASPA included a "grandfather" provision allowing sports betting in those states to continue. >>

locker room after the game, apparently injuring his right hand. This incident was not made public until after the Cavaliers dropped the following three games, ultimately losing the series 4-0. When LeBron's altercation with the white board finally did become public, some sports handicappers observed that had the public known the true nature and extent of LeBron's injury in real time, such knowledge would likely have affected the betting action on the subsequent games. Moreover, the fact that LeBron's injury was not known to the general public, but certainly was known to a small group of insiders, arguably would have given those insiders an advantage had they decided to wager on the remaining games or outcome of the series. Opinions vary as to whether and to what extent this type of scenario deserves regulatory attention.

At the time of PASPA's adoption in 1992, only four states—Nevada, Oregon, Montana and Delaware—allowed some form of sports betting. PASPA included a "grandfather" provision allowing sports betting in those states to continue. Another provision in the law gave New Jersey the option of legalizing sports betting in Atlantic City, providing the state acted within one year of PASPA's adoption. New Jersey initially failed to act within the allotted time, but years later, in 2011, New Jersey voters approved an amendment to the state's constitution allowing the state legislature to authorize sports betting, which it did in 2012. Because of PASPA's apparent prohibition on sports betting outside of the four grandfathered states, New Jersey's efforts to legalize sports wagering were met with considerable controversy and, ultimately, legal attacks by the NCAA and major professional sports leagues. This litigation eventually culminated in last year's decision in Murphy, where the Supreme Court found that PASPA violated the U.S. Constitution's "anti-commandeering" clause. Murphy thus enabled New Jersey to legalize sports betting within its borders, and opened the floodgates for other states to do the same.

Since the Murphy decision, several other states have followed New Jersey's lead. At last count, at least seven states have legalized sports wagering in some form, and many others are currently considering legalization. Three distinct factors drive this trend: (1) consumer demand; (2) a desire for additional state tax revenue; and (3) a belief that legal sports betting will undermine the proliferation of illegal bookmaking. But, with this trend has come a variety of regulatory efforts to ensure the integrity of legal wagering on sporting events. These new regulations vary from state to state, with some regimes much more detailed and onerous than others. Predictably, given the integrity concerns noted above, some new jurisdictions have adopted regulations aimed at prohibiting betting with "inside information." Most new regulatory schemes address this concern by banning certain "insiders" from wagering on certain sporting events because they are presumed to be privy to nonpublic information that could influence the outcome. These prohibited bettor lists typically include players, coaches, referees and others who are team or league insiders, or who otherwise play some role in the game. A few jurisdictions have gone a step further by not merely banning insiders, but also prohibiting any person with "inside information" from wagering. However, defining "inside information" in the sports betting context is not easy. And, even if regulators can craft a workable definition, some gaming experts question whether it is necessary, or even possible, to enforce such rules.

The concept of regulating the use of inside information by individual actors within a marketplace is well-established in the stock trading context. In the United States, federal law includes the Securities Act of 1933 and the Securities Exchange Act of 1934, which, together, provide a range of restrictions and disclosure requirements on the sale of stock by corporate insiders, and impose civil and criminal penalties for violations of these laws. The U.S. Supreme Court, in United States v. Carpenter, explained the rationale behind this regulatory scheme as follows: "[i]t is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit …." This concept may

Mark Starr

seem simple enough in theory, but, in practice, the application of such a ban has been challenging. In fact, for decades, the questions of who qualifies as an insider, what inside information is, and when and how it can and cannot be used when buying and selling stock have been the subject of considerable litigation. In the sports betting context, the foregoing questions will likely be even more vexing.

As noted above, some new sports betting jurisdictions have attempted to address the issue in various ways. For example, New Jersey gaming regulations ban sports wagering by certain categories of persons, including athletes, coaches, referees and others who have a connection with the subject game or event. Pennsylvania goes a step further by banning certain categories of persons—athletes, referees, officials, coaches, managers, trainers, other employees—from wagering on an event "in which the person is participating or otherwise has access to nonpublic or exclusive information." Interestingly, while Nevada has long made it a crime to "place, increase or decrease a bet after acquiring knowledge, not available to all players, of the outcome of the game or any event that affects the outcome of the game …," this prohibition has never been applied to prohibit a bettor with inside information from wagering on a sporting event. Although Nevada regulators did recently adopt a new regulation that prohibits wagers by "an official, owner, coach, or staff of a participant or team or participant" in the event, the new Nevada regulation stops short of specifically prohibiting an otherwise eligible bettor from using inside information. No state has yet attempted to prohibit bettors who, while not officially connected to the game or event, nevertheless possess material or nonpublic information that could affect the outcome of a sporting event.

Beyond state attempts to regulate the use of inside information in the sports betting context, federal legislation was proposed last year that would have both prohibited certain categories of persons—athletes, coaches, officials, etc.—from wagering on an event to which the person has a connection, and would also have prohibited anyone from placing a wager based on "material nonpublic information." However, this bill's prohibition, while largely modeled after the federal securities laws, was very narrow in scope. Basically, the bill would have made it unlawful for a person to make a sports wager if the person is in possession of material nonpublic information relating to the wager, and that person knows that the information had been "obtained wrongfully." The bill defined "obtained wrongfully" as information obtained by theft, bribery, misrepresentation, espionage, deception, or in violation of any federal law protecting computer data, or as the result of a breach of any fiduciary duty or any other personal or relationship of trust and confidence. Thus, while this federal proposal would have gone beyond any of the new state regulations, it was limited to the use of wrongfully obtained inside information.

Going back to the LeBron scenario, it is not clear that any of the current state regulations or the proposed federal law, if enacted, would actually address that situation. Teammates, coaches, trainers, and other team personnel who would have known of LeBron's injury would and, arguably, should be prohibited from betting on Cavaliers games no matter the status of the star's shooting hand, simply because they are affiliated with the team. But what about others who are not team or league insiders, such as an employee of the facility where LeBron's hand was likely x-rayed, or the driver who transported LeBron to the hospital? What about the friend of the locker room attendant who heard about the locker room incident? The information about the Cavaliers' leading scorer obtained by these individuals is certainly material, and is arguably not public, but was it "wrongfully obtained," and should these third parties be prohibited from betting based on what they saw or heard? Is such information truly inside information of the type that should be the subject of regulation?

A real-life case from the stock trading world, but with a sports angle, is illustrative of the challenges in trying to regulate the use of so-called inside information. Back in the 1980s, the Securities and Exchange Commission ("SEC") filed a civil suit against former Dallas Cowboys head coach Barry Switzer, and several others, alleging that they profited from trading stock in a particular company based upon material, nonpublic information. Switzer admitted that he was at his son's high school track meet when he ran into an acquaintance who happened to be the CEO of a local company. Switzer further

admitted that while sunbathing on the bleachers behind where the CEO sat with his spouse, he overheard the two talking about the CEO's desire to sell the company. It was undisputed that Switzer was not part of the conversation between the CEO and his spouse, and Switzer had no connection to the company. Switzer admitted to overhearing the conversation about the sale and thinking it might be material to the company's future stock price, and further admitted to sharing this information with others who, along with him, then purchased shares in the company based on this information. A few days after the defendants purchased the stock, the company publicly announced its intent to liquidate, causing the company's stock price to significantly increase. Switzer and the other defendants then sold their recently purchased shares, each making a profit. Upon the defendants' motion to dismiss the case against them, the court found that although the information overheard by Switzer was material and was not public at the time of the defendants' stock purchases, because the disclosure of the information from the CEO to Switzer did not constitute an improper tip, there was no violation of the securities laws.

Arguably, the driver or hospital employee, or friends of either, in the LeBron scenario are analogous to Switzer and his codefendants. They are not team or league insiders, just as Switzer was not a company insider. LeBron did not intentionally provide material, nonpublic information to others to give them an advantage were they to wager on the next game, just as the CEO did not intend to tip Switzer. Like Switzer and his friends who came upon some information that could affect a stock trade, the third parties in the LeBron scenario just happened to be in the right place at the right time, and learned , but did not wrongfully obtain, a fact that could affect the outcome of a wager. And, just like the judge in the Switzer case did not find a violation of the securities laws, it is hard to see why the LeBron hypothetical would or should be a violation of a gaming regulation.

While potential threats to the integrity of sports betting and to the sports themselves must be taken seriously, regulators would be well-advised not to overreach when considering whether to regulate betting on inside information. Certainly, a prohibition on certain categories of bettors—true insiders like players, coaches, etc.—makes sense. But to go too far in trying to prevent the use of inside information by bettors will likely result in regulations that are both confusing and ineffective, and therefore ultimately unenforceable. :: **CGi**

REFERENCES

1.Murphy v. Nat'l Collegiate Athletic Ass'n, 138 S. Ct. 1461 (2018).

2.See AM. GAMING ASS'N., STATE OF THE STATES 2019: AGA SURVEY OF THE COMMERCIAL CASINO INDUSTRY (2019).

3.PASPA, 28 U.S.C. § 178 (1992).

4.Murphy, 138 S. Ct. at 1482.

5.Carpenter v. United States, 484 U.S. 19 (1987).

6.N.J. Admin Code § 13:69

7.58 Pa Code § 1401 et seq.

8.See Sports Wagering Market Integrity Act, S. 3793, 115th Cong. (2019).

9.Id. § 302(b)(3).

10.See SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984).

GREG BROWER & MARK STARR

With more than 20 years of experience both as a first-chair litigator and in public service, Greg Brower's practice focuses on civil and criminal litigation, as well as regulatory and enforcement actions (including FCPA matters), corporate investigations, cybersecurity matters and federal and state government relations. Most recently, Greg served as the assistant director for the Office of Congressional Affairs at the Federal Bureau of Investigation (FBI), serving as the FBI's chief liaison to Congress on a wide range of critical oversight and investigative matters. He previously served as the FBI's Deputy General Counsel, managing a diverse portfolio of legal matters, including litigation, privacy, procurement, compliance and ethics. During his time as a senior FBI executive, spanning two administrations, he worked closely with high-ranking officials in the U.S. Department of Justice (DOJ), the U.S. intelligence community and with key leaders on Capitol Hill. Greg is a regular commentator and contributor on national security, legal and cybersecurity issues, regularly appearing on CNN and MSNBC, and he is the featured contributor on white collar crime and corporate compliance for the Washington Legal Foundation's Legal Pulse blog.

Even as a young attorney, Mark Starr brings unique expertise in gaming law to his corporate practice. Mark combines an entrepreneurial spirit to his project management experience. While in law school, Mark participated in the drafting, proposal and presentation of Senate Bill prior to its passing by the 2017 Nevada State Legislature. The bill amended state law to allow sports books to offer mutual betting on events outside of horse and dog racing and sports. He also worked as an extern focusing on gaming law and regulation with the Nevada Gaming Control Board.