Private Prediction Markets' Legality Under U.S. Law

by

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I.A Legal Models: Distinguishing Means

Feature: / Type:	Skill-based Trading	Spot Trading	Zero-Sum Trading	Underlying Assets	Risk of Loss Greater than Investment
Prediction Market	yes	yes	usually	no	no
Futures Market	yes	no	yes	usually	yes
Securities Market	yes	usually	no	usually	sometimes
Gambling Market	no	yes	yes	no	sometimes

Market Type v. Market Feature

I.B. Legal Models: Distinguishing Ends

Type: \ Purpose:	Express Prices	Promote Discovery	Entertain	Hedge Risks	Raise Capital
Prediction Market	primary	secondary	tertiary	tertiary?	N.A.
Futures Market	secondary	tertiary?	N.A.	primary	N.A.
Securities Market	secondary	tertiary?	N.A.	tertiary	primary
Gambling Market	N.A.	N.A.	primary	N.A.	N.A.

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. Liablity 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**

<u>Conclusion</u>

      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**.